

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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1986 FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934Bechtel Information Services
Gaithersburg, Maryland
For the Fiscal Year Ended
December 31, 1986

Commission File Number 1-5026

G A F Corporation

Delaware
State of Incorporation:

1361 Alps Road, Wayne, New Jersey

Telephone Number:

(201) 628-3000

13-0762027
(IRS Employer
Identification No.)
07470

RECD S.B.O.

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Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$1.00 per share	New York Stock Exchange
11 3/4% Senior Subordinated Notes due 1995	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

As of March 16, 1987, 35,553,085 shares of common stock were outstanding. The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 16, 1987 was \$1,396,734,096. The aggregate market value was computed by reference to the closing price on the New York Stock Exchange of the registrant's Common Stock on such date (\$43 1/4). For purposes of this computation, voting stock held by officers and directors of the registrant has been excluded. Such exclusion is not intended, and shall not be deemed, to be an admission that such officers and directors are affiliates of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

1. The Company's Proxy Statement for the 1987 Annual Meeting of Shareholders is incorporated by reference in Part III, Items 10, 11, 12 and 13.
2. The Company's Annual Report to Shareholders for the year ended December 31, 1986 is incorporated by reference in Part I, Item 1, and in Part II, Items 5, 6, 7 and 8.

Total Of Sequentially Numbered Pages 163Exhibit Index on Sequentially Numbered Page 29

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PART I

Item 1. Business.

The Company was incorporated under the laws of the State of Delaware in 1929. On July 1, 1986, the Company incorporated its domestic chemicals and building materials divisions so that each of these business units is now operated as a wholly-owned subsidiary of the Company. GAF Corporation has its principal executive offices at 1361 Alps Road, Wayne, New Jersey 07470, telephone (201) 628-3000. Unless the context otherwise requires, the "Company" refers to GAF Corporation and its subsidiaries.

The Company's principal domestic operations are conducted through its wholly-owned subsidiaries: (i) GAF Chemicals Corporation ("GAF Chemicals"), which operates six specialty chemical plants and four mineral granules plants, (ii) GAF Building Materials Corporation ("GAF Building Materials"), which operates ten roofing plants, two glass fiber plants and one glass mat plant, and (iii) GAF Broadcasting Company, Inc. ("GAF Broadcasting"), which owns and operates a classical music FM radio station, WNCN, in the New York City market. The Company's international operations are conducted through a number of wholly-owned foreign subsidiaries, branches and independent distributors. In addition, a specialty chemical plant is operated by GAF-Hüls Chemie GmbH ("GAF-Hüls"), a joint venture between the Company and Hüls A. G. in Marl, West Germany.

Financial information concerning the Company's industry segments required by Item 1 is included in the Company's Annual Report to Shareholders for the fiscal year ended December 31, 1986 (the "Annual Report") in Note 8 of the Notes to Consolidated Financial Statements.

GAF CHEMICALS CORPORATION

GAF Chemicals manufactures and sells two major groups of specialty chemicals (acetylene derivatives and surfactants) and a line of mineral roofing granules.

Acetylene Derivatives

GAF Chemicals manufactures more than 75 different chemical products derived from acetylene. Manufacturing operations include a wide variety of pressure, temperature, catalytic and other processing steps. These specialty chemicals are sold primarily to the pharmaceutical, cosmetics, plastics, automotive, agricultural, textiles, oil and gas, paper and print coatings industries worldwide. These products are marketed in four groups: intermediates, solvents, polymers and vinyl ethers.

Intermediates include butanediol, THF (tetrahydrofuran), butynediol, butenediol, propargyl alcohol and Butoxyne® 497. Butanediol is used by GAF Chemicals as raw material in manufacturing solvents, polymers and vinyl ethers. Butanediol is also sold to customers, primarily for use in engineering plastics, urethane elastomers and thermoplastic urethanes. Propargyl alcohol is sold primarily in the oil field and agricultural markets. Butynediol and Butoxyne 497 are sold primarily to the metal plating industry. Butenediol is used as an intermediate in biocides and pharmaceuticals.

Solvents are sold to customers as high performance products for use in a variety of industries and include BLO® (butyrolactone), THF, M-Pyrol® or NMP® (N-methyl-2-pyrrolidone) and 2-Pyrol® (2-pyrrolidone). They are used by GAF Chemicals in manufacturing polymers and other downstream products. They are sold to customers for use in agricultural, foundry binder resin and lithographic applications (BLO); agricultural, wire and other coatings, plastics, electronic microchips and integrated circuits, lubrication oil extraction and gas purification applications (M-Pyrol); vinyl top coatings, magnetic tape and PVC cements applications (THF); and pharmaceutical, veterinary and coatings applications (2-Pyrol). Since 1985, M-Pyrol has been granted "exempt from tolerance" status by the U. S. Environmental Protection Agency for preharvest use as an inert ingredient in agricultural chemical products.

Polymers are sold for specific applications in the cosmetics, pharmaceutical, energy, chemical manufacturing, beverage, adhesives and radiation curing industries. V-Pyrol® (N-vinyl-2 pyrrolidone), the monomer from which PVP polymers and other downstream products are derived, is itself used as a reactive diluent for the radiation curing industry, a comonomer for the manufacture of viscosity index

improvers for premium motor oils as well as enhanced oil recovery chemicals and as a pigment dispersant. The vinylpyrrolidone based polymers include Plasdone® polyvinyl pyrrolidone (PVP) and Polyplasdone® and Polyclar® polyvinyl polypyrrolidone products. The major applications for PVP polymers are in the cosmetic and pharmaceutical industries respectively. PVP is used as a binder, stabilizer, protective colloid, film-former, adhesive detoxicant, adjuvant and viscosity modifier, pharmaceutical excipient, drug and vitamin tablet binder, coating agent and processing aid in fluid bed granulation. New transdermal devices utilize these polymers to provide time-controlled medication designed to remain active over long periods of time. Polyplasdone XL and XL10 products are used as drug and vitamin tablet disintegrants. Polyclar® AT and Polyclar® 10 are used as clarifiers and chill-hazing agents for beer, wine, fruit juices and other beverages. PVP-Iodine is a water soluble, non-staining, microbiocidal product used in human and veterinary applications. Gafquat® products are film-forming polymers used in hair care products like the popular mousse products, as well as conditioners, gels and glazes. Ganex® polymers are alkylated pyrrolidones showing varying degrees of solubility in water or in mineral oil and solvents which are used in cosmetic applications such as water-resistant eyeliner and lipstick, and industrial applications such as a film former in shoe polishes and a dispersant in agricultural chemical formulations. Copolymers of vinyl pyrrolidone and vinyl acetate, the PVP/VA copolymers, are used extensively for adhesives and for various hair care products.

Vinyl Ethers include monomers and copolymers marketed under the Gantrez® trademark and are primarily used in the cosmetics and pharmaceutical fields. Reactive monomers are employed as building blocks for various agricultural and pharmaceutical chemicals. Applications of the copolymers in cosmetics include hair sprays, hair styling and other hair care products, while in the pharmaceutical field, denture adhesives and tartar control toothpaste are the major uses. The Gantrez copolymers are also used as film formers in coatings, stabilizers in adhesives and other industrial uses and as thickeners and crystal growth inhibitors in detergent formulations.

Surfactants

GAF Chemicals manufactures and sells surfactants (surface active agents) and specialty phosphate esters. Surfactants are organic chemical compounds that possess detergent, emulsifying, dispersing, foaming, penetrating and wetting properties. A major part of surfactant output is used in the production of packaged soaps and detergents for household, industrial and institutional uses. The balance is used in pulp and paper making; the manufacture of agricultural chemicals, cosmetics, polymer emulsions, metal lubricants, paints and pharmaceuticals; textile and leather processing; oil drilling operations; and many other products.

GAF Chemicals' broadest surfactant product line is the Igepal® series of alkylphenol ethoxylated surfactants sold primarily to customers for use in (1) household, industrial and institutional detergents, (2) emulsion polymerization and (3) textiles. Igepal surfactants have a wide variety of uses, including detergent compounding (laundry, dry cleaning, dairy, metal and household applications), washing and scouring of natural and man-made textile fibers, paper deinking, corrosion inhibiting, water repellent finishes, rewetting agents for paper towels and tissues, wetting and spreading agents in water based paints and for emulsion polymerization of vinyl acetate and polyvinyl acetate and other synthetic latex emulsions.

GAF Chemicals' Alipal® products are a line of anionic high foaming and frothing, emulsifier agents and detergents, often produced for a small number of customers for use in specific applications. Major users are the emulsion polymerization, pharmaceutical, agricultural and cosmetics industries.

The largest applications of Antara® and Gafac® phosphate esters are deresination of hardwood pulps and corrosion inhibitors in coatings. Antara phosphate esters are sold to the metal working industry and Gafac phosphate esters are sold to a variety of industries, from paper to agriculture.

The major markets for Igepon® alkyl ester surfactants are synthetic soap bars, dentifrices, shampoos and other cosmetic preparations, textile processing and agricultural dispersants.

Antarox® nonionic surfactants are low foaming additives for commercial and industrial detergents and are primarily sold for use in spray metal cleaners, machine dishwashing detergents, rinse aids and textile processing.

Pegol® block copolymer nonionic surfactants are low to high foaming additives or processing aids for diverse applications such as rinse aids, dishwashing detergents, fiber spin finishes, textile processing, and cosmetic and pharmaceutical gels.

Specialty phosphates are used by manufacturers of floor waxes and finishes as leveling agents, and by plastic manufacturers as low temperature vinyl plasticizers.

Mineral Granules

GAF Chemicals mines and crushes nonporous basalt rock, from its own quarries, producing various types of natural and ceramic coated mineral granules which it sells to the roofing industry for use as a mineral surface on asphalt roofing. The use of granules in roofing contributes substantially to its weathering capability and imparts the decorative coloration to shingles. Two groups of by-products from the manufacture of granules are also marketed as mineral filler for the asphalt coating of shingles and tennis court materials.

GAF Chemicals' granules business benefits from the current trend among roofing manufacturers to convert production to glass fiber substrate as the glass product requires more granules per unit of asphalt roofing. In addition, the increased popularity of heavyweight three-dimensional shingles which simulate wood has increased granule demand in that they require 25 percent more granules than lower-cost, commodity shingles. Granules and their by-products are sold to asphalt roofing manufacturers throughout most of the United States and in Canada. GAF Building Materials is GAF Chemicals' largest purchaser of granules. These purchases are at market prices.

Other Products

GAF Chemicals manufactures iron carbonyl and iron powders for the aerospace, electronics and powder metallurgy industries.

Raw Materials

The raw materials used in the production of chemical products are purchased from a large number of outside sources, in many cases pursuant to supply contracts. Certain of the raw materials, including acetylene, are obtained from limited sources pursuant to long-term supply contracts. With respect to acetylene, GAF Chemicals is supplied domestically at three locations by two suppliers. GAF Chemicals' products may also be manufactured from butanediol (additional quantities of which may be imported from GAF-Hüls in West Germany). GAF Chemicals believes that, in the event of interruption of supply of raw materials from current sources, it could obtain adequate supplies from alternate sources.

Raw materials derived from petroleum or natural gas are used in many of GAF Chemicals' manufacturing processes and, consequently, the price and availability of petroleum and natural gas are material to the costs of operations. GAF Chemicals has obtained, and expects to continue to obtain, adequate supplies of these products at reasonable costs.

In connection with its mineral granules operations, GAF Chemicals owns three quarries, with proven reserves of more than twenty years each, located in Annapolis, Missouri, Blue Ridge Summit, Pennsylvania, and Pembine, Wisconsin. In 1985, the Company purchased land adjacent to two of these quarries for additional granules reserves. In 1985 and 1986, capacity was increased at these three plants.

International Operations

The Company's international operations, which are consolidated in the results of GAF Chemicals, consist principally of the marketing and distribution internationally of chemical products manufactured by GAF Chemicals in the United States. Subsidiaries and branches are located in various countries of Western Europe and in Australia, Brazil, Canada, Japan, Mexico and Singapore. In certain locations, sales are made through distributors rather than through local subsidiaries.

The Company's foreign subsidiaries also market outside of the United States the liquid process filtration systems (consisting of filter bags manufactured by three foreign subsidiaries and hardware

produced to the Company's specifications) which are used in the production of pharmaceuticals, cosmetics, paint, food and beverages.

In addition, GAF-Hüls, the West German joint venture, operates a specialty chemical plant for the manufacture of butanediol and THF, which are marketed through the Company's and GAF-Hüls' sales force. In mid-1986, the capacity of that plant was doubled. One of the intermediates produced in that plant, butanediol, is also sold to GAF Chemicals for use as a feedstock in its United States plants to supplement domestic sources.

In 1986, the Company's international operations, including export sales from domestic operations, accounted for approximately 34% of GAF Chemicals' net sales. The Company does not believe there are any unusual risks attendant on its foreign operations. See also Note 9 of the Notes to Consolidated Financial Statements in the Annual Report for financial information by geographic areas.

Patents, Trademarks, etc.

The Company owns approximately 445 domestic and 371 foreign patents and approximately 139 domestic and 695 foreign trademark registrations related to the business of GAF Chemicals. The Company believes its rights under its existing patents and patent applications to be material in order to maintain its present position in the industry. The duration of the existing patents and patent licenses is deemed generally satisfactory.

Seasonal Variations, Working Capital, Customers

Seasonal variations are generally not material to the business of GAF Chemicals.

Inventory balances are generally sufficient to meet customer demand and do not materially deviate from standards for the industry. GAF Chemicals does not generally provide for extended payment terms to customers.

GAF Chemicals sells to a wide variety of industrial customers with particular emphasis on the pharmaceutical and cosmetics industries. No single customer or group of customers under common control is responsible for sales in excess of 10% of the consolidated revenues of the Company. In certain instances a single customer may purchase all, or a significant part, of the output of a particular product. The Company does not believe that the loss of any one such customer would have a material adverse effect on the business of GAF Chemicals.

Backlog, Marketing and Sales, Competitive Conditions

Backlog is not material to the business of GAF Chemicals or any of its principal products.

Sales to the federal government are not material to the business of GAF Chemicals.

GAF Chemicals sells its products primarily through its own sales force in the United States.

GAF Chemicals is the sole United States producer of a complete line of high-pressure acetylene-based chemicals. GAF Chemicals competes in its acetylene derivatives line with a major foreign competitor and with another large company which manufactures substantial quantities of butanediol and THF for its own use and for sale to others.

In the balance of its chemical businesses, GAF Chemicals competes with many companies, certain of which are substantially larger than GAF Chemicals and offer a broader range of products. Generally, GAF Chemicals has responded to this competition by emphasizing product innovation, product quality, reliability of supply and customer service. The Company believes that the great size and diversified nature of the chemical industry makes it impossible to give a meaningful estimate of the relative position of GAF Chemicals in the industry.

Research and Development

Research and Development expenses for both GAF Chemicals and GAF Building Materials in 1986, 1985 and 1984 are presented in Note 1 of the Notes to Consolidated Financial Statements appearing in the

Annual Report and such figures are incorporated herein by reference. Most of the amounts shown were expended by GAF Chemicals.

As of December 31, 1986, 162 employees were engaged in Company-sponsored research and development. GAF Chemicals continued to expand its research and development effort for new products and new applications for existing products. A new product line named "Surfadone™" is under development by GAF Chemicals' researchers. Surfadone surfactants combine GAF Chemicals' surfactant and acrylene chemistries. In addition, GAF Chemicals introduced a number of new or improved products in each of its product lines in 1986.

The Company expended \$911,866, \$568,451 and \$1,473,086 on customer-sponsored research and development services for the years 1986, 1985 and 1984, respectively.

GAF BUILDING MATERIALS CORPORATION

GAF Building Materials manufactures and sells roofing materials to the residential and commercial roofing industries.

Residential Roofing

GAF Building Materials manufactures and sells a complete line of residential roofing shingles. Shingles are made from fiber glass mat, coated with waterproofing asphalt on both sides and surfaced with ceramic coated mineral granules.

GAF Building Materials' principal products are its Sentinel®, Timberline® and Royal Sovereign® brand shingles. Sentinel shingles are GAF Building Materials' standard shingle product line. Timberline premium roofing shingles are a three dimensional, heavyweight, laminated product offering a Class A fire rating, long-term durability and superior aesthetics. The product has gained acceptance as a replacement for wood shake shingles to improve the appearance of homes and enhance the value of property, particularly in arid parts of the country such as Texas and California where fire codes impose strict requirements. Royal Sovereign shingles, introduced nationwide in 1985, are designed to capitalize on the emerging "middle market" for quality roofing shingles at a just slightly higher price than standard Sentinel shingles. All of these types of shingles are sold throughout the United States.

In December 1986, GAF Building Materials introduced its GAF Wood Line™ shingle, a newly designed mid-weight laminated asphalt shingle with a Class A fire rating. This newest addition to GAF Building Materials' line of residential roofing products is manufactured in Mobile, Alabama for distribution in the southern United States. In addition, GAF Building Materials has announced plans to install equipment in its Dallas, Texas, Fontana, California and Baltimore, Maryland plants to manufacture GAF Wood Line shingles.

GAF Building Materials also manufactures and sells roll roofing, a less expensive type of prepared roofing than shingles, which is used primarily on small residential and commercial structures such as cabins, sheds and utility buildings with pitched or gently sloping roof lines. Roll roofing is also made from an asphalt-impregnated glass mat and may be surfaced with granules.

Commercial Roofing

GAF Building Materials markets a complete line of built-up roofing products and accessories for use in the application of built-up roofing. Built-up roofing is a form of roofing which, unlike shingles and roll roofing products, is assembled on the roof by applying successive layers of roofing membrane with hot asphalt, and, in some applications, gravel. Thermal insulation may be applied beneath the membrane.

GAF Building Materials manufactures a quality glass membrane under the trademark Gafglas®, which is made from asphalt impregnated glass fiber mat. In 1984, GAF Building Materials completed its total conversion to glass fiber built-up roofing and, with its captive supply of glass fiber, is in a position to take advantage of the expanding glass segment of built-up roofing as the industry phases out organic felts. GAF Building Materials also sells packaged asphalt and accessories such as flashings, vent stacks, fasteners, cements, coatings and roof insulation supplied by other manufacturers.

In the first quarter of 1986, GAF Building Materials started to manufacture and sell modified bitumen products under the trademark Ruberoid® MB in the United States. This successful new product line consists of roofing membranes utilizing polymer modified asphalt reinforced with a tough polyester nonwoven mat. Modified bitumen systems provide high performance characteristics, such as weather and water resistance, and labor cost savings due to ease of application. GAF Building Materials' Mount Vernon, Indiana plant was expanded to install a new manufacturing line for several varieties of modified bitumen roofing membranes.

Raw Materials

The major raw materials required for the manufacture of GAF Building Materials' roofing products are asphalt, glass fiber, glass fiber mat, filler (generally crushed or pulverized limestone, granite or sand) and granules. Asphalt and filler are available from a large number of suppliers. GAF Building Materials currently has contracts with several of these suppliers, with others available as substitutes. Five of GAF Building Materials' roofing plants have easy access to deep water ports allowing delivery of asphalt by ship, the most economical means of transport.

Roofing granules are purchased from GAF Chemicals and from other suppliers. Over the last several years, the industry has switched from organic felt to glass fiber mat as the "substrate" or base layer for roofing products. Shingles made with glass mat require substantially less asphalt than do shingles made from an organic felt mat, reducing costs for asphalt and increasing use of granules. GAF Building Materials has a plant which makes glass fiber mat for internal consumption and two plants which manufacture chopped glass fiber for mat substrate, permitting complete integration of the roofing manufacturing process.

Patents, Trademarks, etc.

The Company owns approximately 40 domestic and 53 foreign patents and approximately 66 domestic and 190 foreign trademark registrations related to the business of GAF Building Materials. The Company believes the patent protection covering certain of its products to be material to those products, but patents are not of material significance to the business of GAF Building Materials, nor to the industry generally. The duration of the existing patents and patent licenses is deemed generally satisfactory.

Seasonal Variations, Working Capital, Customers

Sales of roofing products in the northern regions of the United States generally decline during the winter months due to adverse weather conditions. To maintain a more constant level of manufacturing and sales, GAF Building Materials has followed in 1986, as well as in previous years, the practice of "winter dating," in such regions, pursuant to which advantageous extended credit terms are offered to creditworthy customers who order and accept delivery of roofing and insulation during the winter months. A "winter dating" program is also being offered to customers in 1987.

No single customer or group of customers under common control is responsible for sales in excess of 10% of the consolidated revenues of the Company.

Backlog, Government Sales, Competitive Conditions

Backlog is not material to the business of GAF Building Materials or any of its principal products.

Sales to the federal government are not material to the business of GAF Building Materials.

The roofing products industry is highly competitive and includes at least five other major competitors and numerous regional competitors. Competition is based largely upon price, distribution capability, complementary products, credit terms and raw materials supply. GAF Building Materials, through its strategic plant locations, is well positioned in the marketplace, especially for sales to distributors, as a result of favorable raw material costs and the fact that it offers the most complete line of residential roofing products in the industry.

GAF Building Materials markets its roofing products through its own sales force which is based in district sales offices across the United States. A major portion of its sales are to wholesale distributors who resell to roofing contractors and dealers. The remainder of the sales are either to retailers who sell to the consumer market or direct sales to the construction industry.

For several years, prices in the roofing industry have declined. To meet this trend, GAF Building Materials maintains aggressive programs to reduce raw material and other costs, automate production facilities, introduce new products, emphasize sales of profitable high value-added products and maintain sales at a relatively high level in relation to plant capacities.

Research and Development

GAF Building Materials is constantly engaged in new products development and process improvements leading to cost savings and increased manufacturing efficiencies. During the first quarter of 1987, GAF Building Materials also announced the introduction of two new products: the Timberex™ enhanced hip and ridge and the Weather Watch™ waterproofing shingle underlayment, which acts as an ice and water barrier.

GAF BROADCASTING COMPANY, INC.

GAF Broadcasting owns and operates WNCN, 104.3-FM, a commercial radio station broadcasting classical music and cultural programs in the New York City metropolitan area. WNCN is on the air 24 hours a day, 7 days a week. GAF Broadcasting also publishes a monthly magazine, *Keynote*, which is devoted to classical music and the arts and includes a complete program guide for the radio station.

See "Item 3. Legal Proceedings" below for a description of a pending lawsuit concerning WNCN.

Investments

The Company holds a variety of short-term investments in domestic and foreign instruments, including preferred and common stock, fixed income securities and risk arbitrage, dividend capture and stock/futures arbitrage positions selected to maximize income return. The average amount invested in these programs during 1986 was approximately \$247 million. These investments are reviewed on a regular basis by the Audit Committee of the Board of Directors and by the full Board.

The Company from time to time purchases securities in other corporations. During 1986, the Company acquired over 9%, but less than 10%, of the outstanding common stock of Borg-Warner Corporation and CBI Industries, Inc. and, as of the end of the year, the Company held those positions as well as positions in the stock of other publicly-owned companies, including Union Carbide Corporation. On March 27, 1987, the Company acquired additional shares of the common stock of Borg-Warner, bringing the Company's holdings to approximately 19.9% of Borg-Warner's outstanding common stock.

Financial information concerning the Company's investments is included in Note 2 of the Notes to the Consolidated Financial Statements in the Annual Report and in Schedule I, included at page 22 of this Report.

On October 2, 1986, the Company signed an agreement with Union Carbide in which the Company agreed not to acquire, directly or indirectly, any additional shares of voting stock of Union Carbide, except in limited circumstances, for a period of ten years. The Company may, however, dispose of some or all of its shares, subject to certain limited restrictions, the principal one of which is that the Company may not sell any of its shares to any person or group which would, after the sale, own, or have the right to acquire, 5% or more of Union Carbide's voting stock. However, the Company may sell 5% or more of its shares to a broker which agrees to similar restrictions on resale. On November 10, 1986, the Company sold 5 million shares of common stock of Union Carbide and currently owns less than 5% of its outstanding common stock after giving effect to Union Carbide's 3 for 1 stock split effected in early 1986.

Other Corporate Developments

In June 1986, the Company sold its engineering thermoplastics business, the third and smallest of its specialty chemicals businesses, to Celanese Corporation, in order to permit the Company to direct its resources to its two larger chemical groups, acetylene derivatives and surfactants. In August 1986, GAF Chemicals purchased the surfactants and phosphate esters businesses, including a manufacturing plant in Spartanburg, South Carolina, from Borg-Warner Chemicals, Inc. The acquisition of the Spartanburg plant expanded GAF Chemicals' current line of surfactant products to include a specialty line of oil field production chemicals, a group of low-foaming block polymers for household cleaners and the phosphate ester product line described under "Surfactants" above. It also provided GAF Chemicals with a manufacturing facility in the Southeast where there is significant customer demand for these and other GAF Chemicals surfactant products.

In June 1986, the Company entered into a \$100 million three-year revolving credit facility with a consortium of ten banks, replacing the Company's previous \$75 million revolving credit facility, which had been increased from \$50 million in May 1986.

Due to generally reduced availability and increased costs in the market for liability insurance, particularly for chemical manufacturers, the Company continues essentially to self-insure its general liability risks. Coverage of such risks is funded in part through GAF Insurance Ltd., a wholly owned subsidiary of the Company in Bermuda. The Company intends to resume the purchase of liability insurance in the market at such time as availability and costs indicate that this is desirable.

In November 1986, the Company issued \$155 million of 10¼% Senior Subordinated Notes due 1994 and \$105 million of 10¼% Senior Subordinated Debentures due 2001. The Notes will be redeemable at any time, at the option of the Company, after October 31, 1991 and the Debentures, at the option of the Company, after October 31, 1995. Interest on both issues is payable semiannually.

In the second half of 1986, the Company redeemed all of its outstanding 5¼% Sinking Fund Debentures due October 1, 1987 and prepaid in full all 9¼% Senior Notes due March 31, 1987 and 8¼% Senior Notes with a final maturity on January 15, 1992.

Protection of the Environment

The discussion as to asbestos-related and environmental lawsuits involving the Company, and appearing in response to "Item 3—Legal Proceedings" below is incorporated herein by reference.

Since 1970, a wide variety of federal, state and local environmental laws and regulations have been adopted and continue to be adopted and amended. By reason of the nature of the Company's past and present operations and certain of the substances which are, or have been, used, produced or discharged by the Company's plants, capital expenditures and increased operating expenses, the amount of which cannot be estimated at this time, may be occasioned by the Company's continuing efforts to deal responsibly with environmental matters.

Activity continues in matters pertaining to compliance with the Toxic Substances Control Act. Systems have been set up for assessing risk to health or environment at early development stages for new products. Pre-Manufacturing Notices for new chemicals to be commercially introduced are filed as required.

The Company believes that compliance with environmental control requirements will not adversely affect its earnings and its competitive position in the industries in which it is engaged. The Company currently has plans to invest approximately \$5 million in 1987, \$6 million in 1988 and \$5 million in 1989 in pollution abatement facilities. Included in these amounts are the costs associated with the improvement and installation of waste water treatment facilities at GAF Chemicals' Linden, New Jersey, plant in order to meet the New Jersey Department of Environmental Protection's new discharge limitations.

Executive Officers of the Registrant

The names and ages of the executive officers of the Company as of March 23, 1987, the time from which they have served as executive officers in their present positions with the Company, are as follows:

<u>Name</u>	<u>Age</u>	<u>Year Elected</u>	<u>Position</u>
Samuel J. Heyman (1)(2)(3)(4)	48	1983	Chairman of the Board and Chief Executive Officer
James T. Sherwin (1)(3)	53	1984	Vice Chairman and Chief Administrative Officer
John A. Brennan	55	1987	Executive Vice President and President, GAF Building Materials Corporation
Carl R. Eckardt (1)	56	1987	Executive Vice President, Corporate Development
Heinn F. Tomfohrde, III	53	1987	Executive Vice President, and President, GAF Chemicals Cor,
Irving Kagan	51	1986	Senior Vice President, General Counsel and Secretary
Raymond J. Lacroix	51	1985	Senior Vice President and Chief Financial Officer
Joel A. Asen	36	1987	Senior Vice President, Treasury and Business Development

- (1) Member, Board of Directors
- (2) Member, Executive Committee
- (3) Member, Retirement Committee
- (4) Member, Investment Committee

The foregoing executive officers will serve until the next annual organization meeting, to be held on April 27, 1987, or until their successors are elected and have qualified.

The following table gives a summary of the positions held during at least the past five years by each officer whose position, or positions, with the Company during that period has not been accounted for by the preceding table.

<u>Name</u>	<u>Age</u>	<u>Years Held</u>	<u>Position Held</u>
James T. Sherwin	53	June 1974 to May 1983	Executive Vice President for Finance and Administration
John A. Brennan	55	May 1985 to January 1987	Senior Vice President and President, Building Materials
		April 1984 to April 1985	Senior Vice President
		January 1977 to April 1984	Vice President
		September 1974 to November 1975	Assistant Treasurer
Carl R. Eckardt	56	May 1985 to January 1987	Senior Vice President and President, Chemicals
		December 1982 to May 1985	Senior Vice President, Worldwide Chemicals
		October 1981 to December 1982	Senior Vice President, International
		August 1979 to October 1981	Vice President
Raymond J. Lacroix	51	April 1985 to present	Senior Vice President and Chief Financial Officer
		April 1984 to April 1985	Vice President and Chief Financial Officer
		October 1983 to May 1984	Vice President and Treasurer
		January 1981 to October 1983	Vice President and Controller
Joel A. Asen	36	May 1985 to January 1987	Vice President, Treasury and Business Development

All executive officers have been in the employ of the Company for more than five years except as follows:

From 1968 to the present date, Mr. Heyman served, and still serves, as Chief Executive Officer, Manager and General Partner of closely-held real estate development companies and partnerships.

Mr. Sherwin had been employed by the Company as Executive Vice President-Finance until May 1983, at which time he resigned to join Triangle Industries, Inc. as Executive Vice President and Chief Financial Officer. In May 1984, Mr. Sherwin rejoined the Company as Vice Chairman and Chief Administrative Officer.

Mr. Kagan had been employed by The Hertz Corporation as Senior Vice President and General Counsel until October 1986 when he joined the Company.

Prior to being employed by the Company in February 1987, Mr. Tomfohrde was a director of Union Carbide Corporation since 1985 and President of Union Carbide Corporation's Specialties and Services Group since 1986. Previously, Mr. Tomfohrde held the following offices with Union Carbide Corporation: President and Chief Operating Officer, responsible for the Consumer & Industrial Products and Services Group in 1985-1986, Executive Vice-President responsible for Engineering & Technology Services Group in 1983-1985 and Corporate Vice-President, Strategic Planning in 1982-1983.

Mr. Asen had been Manager, Business Development, at General Electric Corp. prior to employment with the Company in May 1985.

No arrangements or understandings exist between any executive officer and any other person pursuant to which the officer was selected as such. There is no family relationship between any of the executive officers.

Reference is made to the Proxy Statement for additional information about the executive officers of the Company.

Employees

At January 1, 1987, the Company employed approximately 4,250 people worldwide. At such date, approximately 2,279 employees in the United States and Canada were subject to 23 union contracts, which are effective in most cases for two or three year periods. Of these contracts, 12 have expired or will expire in 1987. During 1986, there were no strikes or work stoppages.

The Company engaged in a "spin-off termination," effective September 1, 1984, of the Retirement Plan for Hourly Paid Employees of GAF Corporation. The Pension Benefit Guaranty Corporation issued a Notice of Sufficiency on said plan in September 1985. Participants received their fully guaranteed benefits in the form of annuities purchased from an insurance company. The actuarially excess assets reverted to the Company.

The Company has in effect various benefit plans which include a non-qualified deferred compensation plan for a group of executives, a capital accumulation plan for its salaried employees, a flexible benefit plan for its salaried employees, a retirement plan for its hourly paid employees, group insurance agreements providing life, accidental death, disability, hospital, surgical, medical and dental coverage and, in addition, the Company has contracted with various health maintenance organizations to provide medical benefits. The Company and, in many cases, the employees contribute to the cost of the above described plans.

Item 2. Properties.

The corporate headquarters of the Company and of its subsidiaries, GAF Chemicals and GAF Building Materials, its principal research and development laboratories, general administrative and financial operations and its principal electronic data processing facility, are located on 100 acres of land and in 10 buildings at 1361 Alps Road, Wayne, New Jersey 07470. The Company leases the facilities and land from a wholly-owned subsidiary, GAF Realty Corporation. The premises are subject to a first mortgage placed on the property in October 1986 as a security for a term loan.

The WNCN studio and GAF Broadcasting are located in leased offices at 1180 Avenue of the Americas, New York, New York.

The Company's domestic and foreign real properties are either owned by, or leased to, the Company or its subsidiaries as described in the list below:

<u>Location</u>	<u>Facility</u>	<u>Subsidiary</u>
Domestic		
Alabama		
Huntsville	Plant*	Chemicals
Mobile	Plant, Sales Office	Building Materials
California		
Fontana	Plant, Sales Office	Building Materials
Irvine	Sales Office*	Chemicals
Irwindale	Plant	Building Materials
Florida		
Tampa	Plant, Sales Office	Building Materials
Georgia		
Savannah	Plant, Sales Office	Building Materials
Illinois		
Elgin	Credit Office*	Building Materials
Lombard	Sales Office*	Chemicals
Indiana		
Mount Vernon	Plant, Sales Office	Building Materials
Kentucky		
Calvert City	Plant	Chemicals
Maryland		
Baltimore	Plant	Building Materials
Hagerstown	Research	Chemicals (Granules)
Massachusetts		
Millis	Plant, Sales Office	Building Materials
Minnesota		
Minneapolis	Plant, Sales Office, Warehouse*	Building Materials
Missouri		
Annapolis	Plant and Quarry	Chemicals (granules)
Kansas City	Warehouse*	Building Materials
New Jersey		
Bound Brook	Plant	Chemicals (granules)
Linden	Plant, Sales Office	Chemicals
South Bound Brook	Sales Office*, Warehouse*	Building Materials
Wayne	Corporate and Subsidiaries Headquarters*, Administrative Offices*, Research Laboratories*	Corporate, Building Materials and Chemicals

<u>Location</u>	<u>Facility</u>	<u>Subsidiary</u>
New York		
New York	Office and Studios*	GAF Broadcasting
North Carolina		
Charlotte	Sales Office*	Chemicals
Ohio		
Cincinnati	Sales Office*	Chemicals
Pennsylvania		
Blue Ridge Summit	Plant and Quarry	Chemicals (granules)
Erie	Plant, Sales Office	Building Materials
King of Prussia	Sales Office*	Chemicals
South Carolina		
Chester	Plant	Building Materials
Spartanburg	Plant	Chemicals
Tennessee		
Nashville	Plant, Research Laboratories	Building Materials
Texas		
Arlington	Sales Office*	Chemicals
Dallas	Plant, Sales Office	Building Materials
Seadrift	Plant	Chemicals
Texas City	Plant	Chemicals
Wisconsin		
Pembine	Plant and Quarry	Chemicals (granules)
Foreign		
Australia		
Melbourne	Sales Office*	Chemicals
Sydney	Sales Office*, Distribution Center*	Chemicals
Austria		
Vienna	Sales Office*, Distribution Center*	Chemicals
Belgium		
Sint-Niklaas	Plant, Sales Office, Distribution Center	Chemicals
Brazil		
São Paulo	Sales Office*, Distribution Center*	Chemicals
Canada		
Mississauga, Ontario	Sales Office*, Distribution Center*	Chemicals
Ville St.Laurent, Quebec	Sales Office*	Chemicals
France		
Paris	Sales Office*, Distribution Center*	Chemicals

<u>Location</u>	<u>Facility</u>	<u>Subsidiary</u>
Great Britain		
Esher	European Headquarters*	Chemicals
Manchester	Sales Office, Distribution Center	Chemicals
Italy		
Milan	Sales Office*, Distribution Center*	Chemicals
Japan		
Tokyo	Sales Office*	Chemicals
Mexico		
Mexico City	Sales Office*, Distribution Center*	Chemicals
The Netherlands		
Schiedam	Sales Office*	Chemicals
New Zealand		
Auckland	Sales Office*, Distribution Center*	Chemicals
Puerto Rico		
Carolina	Sales Office*	Chemicals
Singapore		
Singapore	Sales Office*, Distribution Center*, Regional Headquarters*	Chemicals
Spain		
Barcelona	Sales Office*, Distribution Center*	Chemicals
Sweden		
Johanneshov	Sales Office*, Distribution Center*	Chemicals
Switzerland		
Zug	Sales Office*, Distribution Center*	Chemicals
West Germany		
Frechen	Sales Office*, Distribution Center*	Chemicals
Affiliate: GAF-Hüls Chemie GmbH Marl	Plant, Sales Office	Chemicals

* Leased Property

The Company believes that, in general, these plants and facilities, which are of widely varying ages and of different types of construction, have been adequately maintained, are in good condition and are suitable and adequate for the Company's operations. The Company's major facilities are, in general, satisfactorily utilized and in certain product lines, such as surfactants, operated in 1986 at near or full capacity. Each plant has adequate transportation facilities for both raw materials and finished products. As part of the Company's continuing capital expansion and improvements program, major projects for the renovation of some of the plants and installation of new equipment have been completed in 1986 and more are planned. Capital expenditures were approximately \$34 million in 1986 and are expected to exceed \$50 million in 1987.

Item 3. Legal Proceedings.

As of December 31, 1986, the Company was a co-defendant in approximately 27,000 pending lawsuits involving alleged health claims relating to the inhalation of asbestos fiber. The Company has resolved approximately 20,000 other lawsuits involving similar claims through December 31, 1986. The great majority of these cases have been filed in the last six years. It is anticipated that additional suits will be filed by persons exposed to asbestos at sites where asbestos containing materials manufactured by the Company and others were used. It is impossible to predict the number of such additional lawsuits. However, in 1971 the Company discontinued the sale of its principal asbestos insulation products and in 1975 withdrew from sale of all asbestos products except products in which the asbestos fiber was fully bonded or encapsulated, which products the Company discontinued in 1981.

In May 1979, the Company commenced an action in the Los Angeles, California Superior Court against its insurance carriers to obtain a judicial determination that the defendants are obligated to defend and indemnify the Company, under policies issued from 1947 to 1979, in all present and future asbestos bodily injury cases. In addition, the Company sought compensatory and punitive damages for breach of insurance contracts, violations of the California Insurance Code, bad faith and certain other claims. The action was later consolidated in the San Francisco Superior Court with actions by other asbestos producers against their insurers. Trial commenced on March 4, 1985 and closing arguments on the third phase concluded February 20, 1987. The remainder of the trial is expected to continue through 1987 or longer due to the numerous and complex insurance coverage issues and the number of litigants.

On January 7, 1987, the Company entered into settlement agreements with five of its defendant-carriers in the California litigation described above. These five settlements resolve all of the Company's outstanding claims against these insurers with respect to their asbestos bodily injury coverage and will provide the Company with substantial insurance with respect to pending and prospective asbestos bodily injury claims and related expenses. These carriers have been dismissed from that litigation. However, the Company's suits against the remaining insurers in that litigation will continue. Additionally, in October 1986, the Company commenced a declaratory judgment action in Los Angeles, California Superior Court with respect to the obligations for asbestos bodily injury coverage of certain underwriters at Lloyd's and British insurance companies under liability policies issued to the Company for the years 1979 to 1983.

In connection with these settlements, the Company joined the Wellington Asbestos Claims Facility (the "Facility"), an organization of insurance companies and asbestos producers formed in 1985 to coordinate the administration of asbestos bodily injury claims. From and after January 7, 1987, the Facility will also assume defense and settlements of the Company's pending, threatened and future asbestos bodily injury claims. The Company's share of the costs of settlements, judgments and legal expenses, with respect to all claims handled by the Facility, will be borne by the Facility, which will be reimbursed by the Company's insurers on the basis of the amounts provided under the Facility's agreement with the Company, and to the extent of the coverage afforded the Company under its policies of insurance and settlement agreements. At the same time, the Company entered into a separate agreement with another insurer, with which the Company had previously settled its insurance coverage claims, so as to conform the Company's arrangement with such insurer regarding such settlements and with the Company's entry into the Facility.

In the opinion of management, based in part on the opinion of its General Counsel with respect to the aforesaid health claim lawsuits, the California litigation described above, the aforesaid January 1987

settlements with certain insurance carriers and the Company's entry into the Facility, the ultimate disposition of such lawsuits and litigation will not have a material adverse effect on the Company's financial position.

As of December 31, 1986, the Company is a defendant in approximately 70 pending actions commenced by school districts, municipalities and similar governmental entities and building owners which allege economic and property damage or other injuries in schools or public and private buildings caused, in whole or in part, by what is claimed to be the present or future need to remove asbestos material from those premises. The plaintiffs seek to recover the cost of inspections, removal and/or the replacement of asbestos materials plus health screening examinations, counsel's fees and expenses incurred in connection with the litigation and compensatory and punitive damages. These actions are still in early stages. One of these lawsuits, in the U. S. District Court for the Eastern District of Pennsylvania, has been certified as a class action for certain issues, including punitive damages. This case is in the pre-trial stage. The Company did not sell asbestos spray or acoustical ceiling products, which are the primary products being removed from buildings.

In October 1983, the Company filed a lawsuit in Los Angeles, California Superior Court against its past insurance carriers to obtain a judicial determination that defendants are obligated to defend and indemnify the Company in the asbestos-in-building cases referred to in the preceding paragraph. The Company is seeking declaratory relief as well as compensatory damages. This action is presently in the pre-trial pleading stage. The parties have agreed, in principle, to hold this action in abeyance until such time as they are better able to evaluate developments as they may occur in the underlying asbestos-in-building cases. One of the Company's insurance carriers is currently paying, under reservations of rights, all costs of defense of the asbestos-in-building litigation. Because such litigation is in its early stages and evidence and interpretations of important legal questions are presently unavailable, it is not possible to predict the future of such litigation. In the opinion of management, based in part on the opinion of its General Counsel with respect to the aforesaid asbestos-in-building lawsuits and the October 1983 litigation described above, the ultimate disposition of such lawsuits and litigation will not have a material adverse effect on the Company's financial position.

On February 2, 1981, an action was commenced against the Company and GAF Broadcasting by Concert Radio, Inc. in the Supreme Court, County of New York, seeking specific performance, or, in the alternative, damages arising out of the alleged breach of an option agreement for the purchase of radio station WNCN. In 1984, the trial court ruled in favor of the plaintiff and ordered specific performance of the option agreement. The Company appealed such judgment to the New York Supreme Court, Appellate Division. In May 1985, the Appellate Division affirmed the trial court ruling that the Company has breached the option agreement to sell radio station WNCN to Concert Radio, Inc., but reversed the portion of the judgment ordering specific performance, thus limiting plaintiff to monetary damages for which a new trial was ordered and is expected to take place in April 1987.

The Company is a defendant (generally one of several) in a number of cases involving allegedly defective commercial roofing products containing felt substrates which the Company has phased out as a component of roofing products. The number of such cases has declined steadily during the last four years. The amounts claimed in a number of these cases are substantial, typically \$100,000 to \$500,000. However, most cases are settled for a fraction of the sum demanded and recovery, if any, from the defendants is frequently apportioned among them, which reduces the burden of such judgments or settlements on the Company.

The Company is a party to a variety of administrative proceedings and lawsuits involving environmental matters, including being named as a defendant, together with numerous other companies, in several lawsuits under the Comprehensive Environmental Response, Compensation and Liability Act (commonly known as "CERCLA" or the "Superfund Law") and similar state laws which seek to recover from generators of hazardous waste the cost of cleaning up so-called "orphan" waste disposal sites. Most of the lawsuits involving orphan dumpsites are in the early stages. Due to the practices of waste disposal haulers and disposal facilities prior to adoption and implementation of the environmental laws and

regulations, evidence is difficult to obtain or evaluate and important legal questions have not yet been answered. The Company plans to seek dismissal of some of the lawsuits and proceedings on grounds that there appears to be no substantial evidence that there is any hazardous waste of the Company present at the dumpsites in question; and, in other cases, to seek such resolution as may be appropriate in light of the recently enacted legislation amending the Superfund Law entitled "Superfund Amendments and Reauthorization Act of 1986." In each lawsuit, it is expected that liability, if any, will eventually be apportioned among the companies, including the Company, found responsible for the presence of hazardous waste at the dumpsite. Based on evidence presently available, it is impossible to predict the eventual liability of the Company in these orphan dumpsite lawsuits. In the opinion of management, based in part on opinion of its General Counsel, these lawsuits should be resolved gradually over a period of years for amounts which are not material to the financial position of the Company.

A description of certain legal proceedings involving the Company and its former and present directors and officers may be found in the Proxy Statement under "Proposal No. 1—Election of Directors—Certain Litigation Involving Directors".

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during the fourth quarter of 1986.

PART II

The information required by Items 5, 6, 7 and 8 is incorporated by reference to the Company's Annual Report as follows:

	<u>Annual Report Page Number</u>
Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.....	26
Item 6. Selected Financial Data	26
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	23-25
Item 8. Financial Statements and Supplementary Data	
Auditors' Report	37
Consolidated Statements of Income for the three years ended December 31, 1986	27
Consolidated Balance Sheets as of December 31, 1986 and 1985.....	28
Consolidated Statements of Changes in Financial Position for the three years ended December 31, 1986	29
Consolidated Statements of Shareholders' Equity for the three years ended December 31, 1986	30
Notes to Consolidated Financial Statements	31-36
Supplementary Data (Unaudited): Quarterly Financial Data	37

Item 9. Disagreements on Accounting and Financial Disclosure.

None.

PART III

Item 10. Directors and Executive Officers of the Registrant.

The information required by Item 10 is incorporated by reference to the Proxy Statement under the caption "Proposal No. 1—Election of Directors—Nominees". For the information required as to Executive Officers, see Part I, "Item 1. Executive Officers".

Item 11. Executive Compensation.

The information required by Item 11 is incorporated by reference to the Proxy Statement under the caption "Proposal No. 1—Election of Directors--Executive Compensation and Certain Transactions".

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The information required by Item 12 is incorporated by reference to the Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management".

Item 13. Certain Relationships and Related Transactions.

The information required by Item 13 is incorporated by reference to the Proxy Statement under the caption "Proposal No. 1—Election of Directors—Executive Compensation and Certain Transactions—Certain Transactions with Related Parties".

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

The following documents are filed as part of this report:

(a)(1) Financial Statements:

Financial statements of GAF Corporation and subsidiaries are incorporated by reference to the Company's Annual Report to Shareholders for the fiscal year ended December 31, 1986. See list on page 17 herein.

(a)(2) Financial Statement Schedules:

The following supplementary financial information is filed in this Form 10-K and should be read in conjunction with the financial statements in the Annual Report.

	Page Number in this Form 10-K
Report of Independent Public Accountants on Schedules for the years ended December 31, 1986, 1985 and 1984.....	21
Schedule I— Marketable Securities—Other Investments	22
Schedule V— Property Plant and Equipment.....	23
Schedule VI— Accumulated Depreciation of Property, Plant and Equipment	24
Schedule VIII— Valuation and Qualifying Accounts	25

Schedules, other than those listed above, are omitted because of the absence of the conditions under which they are required or because the required information, where material, is shown in the financial statements or the notes thereto.

(a)(3) Exhibits:

- 3.1 —Restated Certificate of Incorporation (See Exhibit 3.1 to the Company's Form 10-K for the year ended December 31, 1985).
- 3.2 —Certificate of Amendment of Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on April 28, 1986.
- 3.3 —Bylaws of the Company.
- 4. —Instruments defining the rights of security holders, including indentures. The Company hereby undertakes to furnish copies of any long-term debt instruments to the SEC upon request.
- 10.1 —Executive Incentive Compensation Plan, as amended through October 18, 1979 (See Exhibit A(1) to the Company's Form 10-K for the year ended December 31, 1979), amendment thereto (See Exhibit 10.6 to the Company's Form 10-K for the year ended December 31, 1982).
- 10.2 —Plan for the Sale of Restricted and Unrestricted Common Stock to Employees Who Perform Executive, Administrative or Supervisory Functions (the "Restricted Stock Purchase Plan"), as amended through September 23, 1982 (See Exhibit 10.7 to the Company's Form 10-K for the year ended December 31, 1983).
- 10.3 —1975 Stock Option Plan (See Exhibit 10.9 to the Company's Form 10-K for the year ended December 31, 1982), amendment thereto (See Exhibit 10.09 to the Company's Form 10-K for the year ended December 31, 1982).
- 10.4 —Unanimous written consent of the Stock Option Committee, dated July 22, 1982, amending the Company's stock option agreements to include Limited Rights (See Exhibit 10.11 to the Company's Form 10-K for the year ended December 31, 1982).
- 10.5 —1984 Employee Stock Option Plan (See Exhibit 10.2 to the Company's Form 10-Q for the quarter ended April 1, 1984).
- 10.6 —Deferred Compensation Letter Agreement dated December 11, 1985 (See Exhibit 10.7 to the Company's Form 10-K for the year ended December 31, 1985).
- 10.7 —Agreement dated October 2, 1986 with Union Carbide Corporation (See Exhibit 7 to Amendment 15 to the Company's Schedule 13D relative to Union Carbide Corporation filed by the Company on October 7, 1986).
- 10.8 —Amendment to the Restricted Stock Purchase Plan, dated February 24, 1986.
- 11. —Computation of Earnings per Common Share for the Three Years ended December 31, 1986.
- 13. —Annual Report to Shareholders for the fiscal year ended December 31, 1986.
- 21.1 —Proxy Statement for the Company's 1987 Annual Meeting of Shareholders.
- 21.2 —Form 8-K, dated January 7, 1987, filed by the Company on January 12, 1987.
- 22. —Subsidiaries of the Company.
- 24.1 —Consent of Arthur Andersen & Co., Independent Public Accountants, included at page 21 of this Report.

(b) Reports on Form 8-K.

No report on Form 8-K was filed with the Securities and Exchange Commission during the last quarter of 1986. A report on Form 8-K, concerning the partial settlement of the Company's asbestos bodily injury insurance litigation and the Company's joining the Wellington Asbestos Claim Facility was filed on January 12, 1987.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GAF CORPORATION
(Registrant)

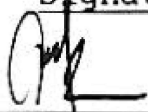
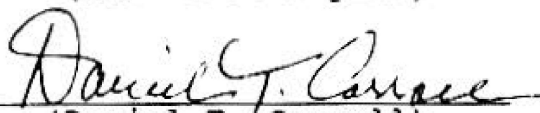


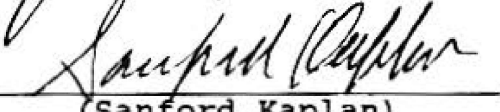
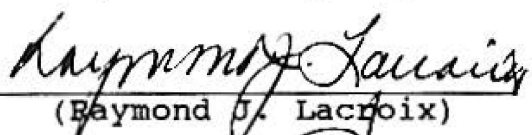
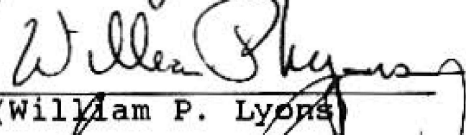
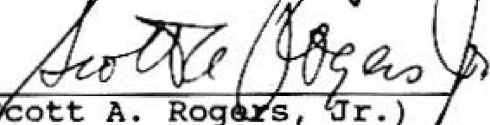
Date: March 23, 1987

By



(Samuel J. Heyman)
Chairman of the Board
and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
 (Samuel J. Heyman)	Chairman of the Board and Chief Executive Officer	March 23, 1987
 (Daniel T. Carroll)	Director	March 23, 1987
 (Carl R. Eckardt)	Director and Executive Vice President	March 23, 1987
 (Jacob E. Goldman)	Director	March 23, 1987
 (Sanford Kaplan)	Director	March 23, 1987
 (Raymond J. Lacroix)	Senior Vice President and Chief Financial Officer	March 23, 1987
 (William P. Lyons)	Director	March 23, 1987
 (Scott A. Rogers, Jr.)	Director	March 23, 1987

Edward E. Shea

(Edward E. Shea)

Director

March 23, 1987

James F. Sherwin

(James F. Sherwin)

Director and
Vice Chairman

March 23, 1987

William Spier

(William Spier)

Director

March 23, 1987

Joseph D. Tydings

(Joseph D. Tydings)

Director

March 23, 1987

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON SCHEDULES

GAF CORPORATION:

In connection with our examinations of the consolidated financial statements included in GAF Corporation's annual report to shareholders and incorporated by reference in this Form 10-K, we have also examined the schedules as listed in the index on page 18 of this Form 10-K. Our examinations of the consolidated financial statements were made for the purpose of forming an opinion on those statements taken as a whole. The schedules are presented for purposes of complying with the Securities and Exchange Commission's rules and are not part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the examinations of the basic financial statements and, in our opinion, fairly state in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.


ARTHUR ANDERSEN & CO.

Roseland, New Jersey
February 9, 1987

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports incorporated by reference or included in this Form 10-K, into the Company's previously filed Registration Statements on Form S-8 (Nos. 2-53686, 2-41036, 2-92203, 2-92202 and 2-336424).


ARTHUR ANDERSEN & CO.

Roseland, New Jersey
March 30, 1987

GAF CORPORATION AND SUBSIDIARIES
MARKETABLE SECURITIES—OTHER INVESTMENTS

As of December 31, 1986

(Dollars in Thousands)

Title of Issue	Principal Amount or Number of Shares	Cost	Market Value at December 31, 1986	Balance Sheet Carrying Amount
Short-Term Investments				
A) DEPOSITS				
Time Deposits	\$123,500	\$123,500	\$123,500	
Certificates of Deposit	20,212	20,212	20,212	
Total Deposits	<u>\$143,712</u>	<u>\$143,712</u>	<u>\$143,712</u>	\$143,712
B) SECURITIES				
1) Government Securities				
U.S.	\$ 3,820	\$ 3,820	\$ 3,820	
Foreign	18,417	18,417	18,417	
Total	<u>22,237</u>	<u>22,237</u>	<u>22,237</u>	
2) Repurchase Agreements				
	<u>10,500</u>	<u>10,500</u>	<u>10,500</u>	
3) Common Stock*				
Cabot Corporation	1,299,700	39,913	38,991	
Consumer Non-Durable Goods(2)		18,417	19,383	
Chemicals(2)		14,971	15,970	
Diversified Industries(3)		19,096	18,026	
Diversified Financial Companies(1)		7,955	6,249	
Retailing(1)		13,215	12,080	
Diversified Service Companies(2)		15,182	13,670	
Utilities(4)		25,000	25,990	
Other(16)		26,319	25,667	
Total		<u>179,068</u>	<u>176,026</u>	
4) Preferred Stocks*				
Utilities(23)		21,029	20,013	
Other(5)		9,615	9,666	
Total		<u>30,644</u>	<u>29,679</u>	
5) Other				
		<u>25,789</u>	<u>25,686</u>	
Total Securities		<u>\$268,238</u>	<u>\$264,128</u>	\$264,128
Marketable Securities—Common Stock				
1) Borg-Warner Corporation	7,708,300	\$268,242	\$291,779	
2) Union Carbide Corporation	4,684,561	90,695	105,403	
3) CBI Industries, Inc.	2,032,300	53,428	58,683	
Total Marketable Securities		<u>\$412,365</u>	<u>\$455,865</u>	\$412,365

* Figures in parentheses indicate number of companies in group

GAF CORPORATION AND SUBSIDIARIES
PROPERTY, PLANT AND EQUIPMENT

Year Ended December 31, 1986
(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1986</u>	<u>Additions at Cost</u>	<u>Retirements</u>	<u>Other (b)</u>	<u>Balance December 31, 1986</u>
Land	\$ 6,797	\$ 20	\$ 865	\$ —	\$ 5,952
Land improvements	9,963	547	59	—	10,451
Buildings and building equipment	53,631	3,954	771	—	56,814
Machinery and equipment	226,387	22,853	12,566	3,500	240,174
Construction in progress	11,362	6,540 (a)	1,705	—	16,197
	<u>\$308,140</u>	<u>\$33,914</u>	<u>\$15,966</u>	<u>\$3,500</u>	<u>\$329,588</u>

Year Ended December 31, 1985
(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1985</u>	<u>Additions at Cost</u>	<u>Retirements</u>	<u>Other (c)</u>	<u>Balance December 31, 1985</u>
Land	\$ 5,807	\$ —	\$ 426	\$1,416	\$ 6,797
Land improvements	9,242	817	96	—	9,963
Buildings and building equipment	52,558	2,920	3,723	1,876	53,631
Machinery and equipment	200,658	42,235	22,464	5,958	226,387
Construction in progress	10,182	1,189 (a)	9	—	11,362
	<u>\$278,447</u>	<u>\$47,161</u>	<u>\$26,718</u>	<u>\$9,250</u>	<u>\$308,140</u>

Year Ended December 31, 1984
(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1984</u>	<u>Additions at Cost</u>	<u>Retirements</u>	<u>Transfers Between Accounts</u>	<u>Balance December 31, 1984</u>
Land	\$ 6,174	\$ —	\$ 367	\$ —	\$ 5,807
Land improvements	8,895	571	224	—	9,242
Buildings and building equipment	54,385	751	2,558	(20)	52,558
Machinery and equipment	211,049	12,151	22,521	(21)	200,658
Construction in progress	5,714	4,427 (a)	—	41	10,182
	<u>\$286,217</u>	<u>\$17,900</u>	<u>\$25,670</u>	<u>\$—</u>	<u>\$278,447</u>

NOTES

(a) Denotes net change during year

(b) Represents acquisition of chemical facilities from Borg-Warner Chemicals, Inc.

(c) Represents acquisition of glass fiber facilities from Reichhold Chemicals, Inc.

The ranges of annual depreciation rates generally were as follows (applied principally on the straight-line basis):

Land improvements	4-16 2/3%
Buildings and building equipment	2 1/2-12 1/2%
Machinery and equipment	5-33 1/3%

GAF CORPORATION AND SUBSIDIARIES

ACCUMULATED DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT

Year Ended December 31, 1986

(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1986</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Retirements</u>	<u>Balance December 31, 1986</u>
Land improvements	\$ 3,626	\$ 460	\$ 76	\$ 4,010
Buildings and building equipment	24,417	1,989	872	25,534
Machinery and equipment	86,011	15,533	9,896	91,648
	<u>\$114,054</u>	<u>\$17,982</u>	<u>\$10,844</u>	<u>\$121,192</u>

Year Ended December 31, 1985

(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1985</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Retirements</u>	<u>Balance December 31, 1985</u>
Land improvements	\$ 3,236	\$ 500	\$ 110	\$ 3,626
Buildings and building equipment	25,945	2,143	3,671	24,417
Machinery and equipment	90,151	14,723	18,863	86,011
	<u>\$119,332</u>	<u>\$17,366</u>	<u>\$22,644</u>	<u>\$114,054</u>

Year Ended December 31, 1984

(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1984</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Retirements</u>	<u>Transfers Between Accounts</u>	<u>Balance December 31, 1984</u>
Land improvements	\$ 2,895	\$ 538	\$ 197	\$ —	\$ 3,236
Buildings and building equipment	25,762	2,350	2,171	4	25,945
Machinery and equipment	93,092	16,509	19,446	14	90,151
	<u>\$121,749</u>	<u>\$19,397</u>	<u>\$21,814</u>	<u>\$ 18</u>	<u>\$119,332</u>

GAF CORPORATION AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS

Year Ended December 31, 1986

(Dollars in Thousands)

<u>Description</u>	<u>Balance January 1, 1986</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance December 31, 1986</u>
Valuation and Qualifying Accounts Deducted from Assets to Which They Apply				
Allowance for doubtful accounts	\$5,142	\$1,178	\$2,938(a)	\$4,382
Allowance for discounts	1,874	8,782	6,830	3,826
Reserve for inventory valuation	3,627	4,075	2,558	5,144

Year Ended December 31, 1985

(Dollars in Thousands)

<u>Description</u>	<u>Balance January 1, 1985</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance December 31, 1985</u>
Valuation and Qualifying Accounts Deducted from Assets To Which They Apply				
Allowance for doubtful accounts	\$5,426	\$ 703	\$ 987(a)	\$5,142
Allowance for discounts	1,489	7,189	6,804	1,874
Reserve for inventory valuation	4,538	1,356	2,267	3,627

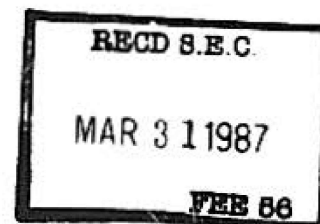
Year Ended December 31, 1984

(Dollars in Thousands)

<u>Description</u>	<u>Balance January 1, 1984</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance December 31, 1984</u>
Valuation and Qualifying Accounts Deducted from Assets To Which They Apply				
Allowance for doubtful accounts	\$4,709	\$1,313	\$ 596(a)	\$5,426
Allowance for discounts	914	6,772	6,197	1,489
Reserve for inventory valuation	7,781	2,967	6,210	4,538

NOTE: (a) Represents write-offs of uncollectible accounts net of recoveries

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549



1986 FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended
December 31, 1986

Commission File Number 1-5026

G A F Corporation

E X H I B I T S

EXHIBIT INDEX

Exhibit No.	Description	Page
3.1	—Restated Certificate of Incorporation (See Exhibit 3.1 to the Company's Form 10-K for the year ended December 31, 1985).	
3.2	—Certificate of Amendment of Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on April 28, 1986.	31
3.3	—Bylaws of the Company.	47
4.	—Instruments defining the rights of security holders, including indentures. The Company hereby undertakes to furnish copies of any long-term debt instruments to the SEC upon request.	
10.1	—Executive Incentive Compensation Plan, as amended through October 18, 1979 (See Exhibit A(1) to the Company's Form 10-K for the year ended December 31, 1979), amendment thereto (See Exhibit 10.6 to the Company's Form 10-K for the year ended December 31, 1982).	
10.2	—Plan for the Sale of Restricted and Unrestricted Common Stock to Employees Who Perform Executive, Administrative or Supervisory Functions (the "Restricted Stock Purchase Plan"), as amended through September 23, 1982 (See Exhibit 10.7 to the Company's Form 10-K for the year ended December 31, 1983).	
10.3	—1975 Stock Option Plan (See Exhibit 10.9 to the Company's Form 10-K for the year ended December 31, 1982), amendment thereto (See Exhibit 10.09 to the Company's Form 10-K for the year ended December 31, 1982).	
10.4	—Unanimous written consent of the Stock Option Committee, dated July 22, 1982, amending the Company's stock option agreements to include Limited Rights (See Exhibit 10.11 to the Company's Form 10-K for the year ended December 31, 1982).	
10.5	—1984 Employee Stock Option Plan (See Exhibit 10.2 to the Company's Form 10-Q for the quarter ended April 1, 1984).	
10.6	—Deferred Compensation Letter Agreement dated December 11, 1985 (See Exhibit 10.7 to the Company's Form 10-K for the year ended December 31, 1985).	
10.7	—Agreement dated October 2, 1986 with Union Carbide Corporation (See Exhibit 7 to Amendment 15 to the Company's Schedule 13D relative to Union Carbide Corporation filed by the Company on October 7, 1986).	
10.8	—Amendment to the Restricted Stock Purchase Plan, dated February 24, 1986.	78
11.	—Computation of Earnings per Common Share for the Three Years ended December 31, 1986.	82
13	—Annual Report to Shareholders for the fiscal year ended December 31, 1986.	84
21.1	—Proxy Statement for the Company's 1987 Annual Meeting of Shareholders.	129
21.2	—Form 8-K, dated January 7, 1987, filed by the Company on January 12, 1987.	157
22	—Subsidiaries of the Company.	163
24.1	—Consent of Arthur Andersen & Co., Independent Public Accountants, included at page 21 of this Report.	

Financial Review

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Management's Discussion and Analysis of Financial Condition and Results of Operations

GAF CORPORATION

Financial Condition

Record earnings and significant increases in cash flow from operations substantially improved the Company's financial condition during 1986 and 1985. The Company's cash flow from operations more than tripled in 1986 to \$313 million after a \$20 million (25%) increase in 1985. Total working capital increased \$315.1 million (178%) to \$492.2 million after a \$36.4 million (26%) jump in 1985, while total assets increased \$467.9 million (53%) in 1986 to \$1.347 billion. Shareholders' equity has nearly tripled in the last two years, from \$214 million at December 31, 1984 to \$298.2 million in 1985 and \$601.5 million as of December 31, 1986.

This improvement in financial condition reflects record high earnings by the Company's Chemicals business, a turnaround by the Building Materials business, and an increase in income on investments from \$4.2 million in 1984 to \$22.4 million and \$77.9 million in 1985 and 1986, respectively. In addition, the Company in 1986 realized extraordinary gains of \$201.4 million, after taxes and expenses, on its investment in Union Carbide Corporation (see Note 2 to Consolidated Financial Statements).

Of the total assets of \$1.3 billion at December 31, 1986, \$864.8 million consists of cash, short-term investments and marketable securities as compared with \$419.4 million and \$69.6 million at December 31, 1985 and 1984, respectively. A substantial portion of this increase in cash and investments was generated from cash flow from operations. The Company's total debt was \$483.2 million at December 31, 1986, compared with \$374.4 million and \$89.3 million at the end of 1985 and 1984, respectively. Total cash and investments at December 31, 1986 were \$24.36 per share, while debt was \$13.61 per share. Debt as a percent of debt plus equity was 29.4%, 55.7%, and 44.5% as of December 31, 1984, 1985 and 1986, respectively.

In November 1986, the Company issued \$155 million of 10 3/8% senior subordinated notes due 1994 and \$105 million of 10 7/8% senior subordinated debentures due 2001. The notes are redeemable after October 31, 1991, and the debentures after October 31, 1995. Annual sinking fund payments of 18.75% of the principal amount of the deben-

tures originally issued, commencing November 1, 1997, are calculated to retire 75% of their principal amount prior to maturity. These securities will be subordinated to all existing and future senior indebtedness of the Company. Net proceeds were approximately \$249.1 million, after expenses and discounts.

In October 1986, the Company placed a \$38.1 million mortgage on the Company's headquarters property. The mortgage is due on October 8, 1996, and interest on the funds is at a rate based on the London Interbank Offer Rate. The funds were utilized mainly for repayment of debt. An \$8.7 million capital lease obligation for the headquarters property due in August 1997 was paid as of September 30, 1986.

On June 30, 1986, the Company entered into a \$100 million three-year revolving credit facility with a consortium of ten banks, replacing the Company's previous \$75 million revolving credit agreement, which had been increased from \$50 million in May 1986. Interest on borrowings is, at the option of the Company, at the prime rate, a rate based on the London Interbank Offer Rate, or a rate based on the Certificate of Deposit Rate. The agreement includes certain restrictions on dividends and provisions for the maintenance of minimum working capital, net worth and limitations on debt which provide greater flexibility than the restrictions contained in the prior agreement. There were no borrowings outstanding under this agreement at December 31, 1986.

Total working capital increased in 1986 to \$492.2 million. The working capital ratio improved from 1.70:1 at December 31, 1985, to 3.95:1. Short-term debt fell in 1986 from \$115.4 million to \$2.8 million. Cash flow from other working capital items in 1986 totaled \$42.6 million. Reflecting tight controls, total inventories were reduced by \$7.8 million (8%) in 1986 to \$86.2 million. Increases in payables and accruals contributed \$41.7 million to cash flow. Accrued liabilities increased \$20.4 million (35%) to \$79.3 million, reflecting increases in various Company reserves. Other liabilities increased \$18 million (22%) to \$98.5 million, reflecting accrued expenses relating to the Company's investment in Union Carbide.

The Company's capital expenditures have increased to \$33.9 million and \$47.2 million in 1986 and 1985, respectively, as compared with \$17.9 million in 1984. Capital

Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

expenditures in 1987 are expected to exceed \$50 million. The increased capital outlays were part of the \$118 million capital expansion program announced in late 1984 to substantially increase production capacity at several of the Company's domestic and foreign operations. In addition, the Company completed in 1986 a major capacity expansion at its joint-venture manufacturing facility in West Germany, which doubled the capacity of that plant.

Results of Operations

1986 Versus 1985

GAF in 1986 recorded the highest earnings in its history, both in terms of net income and income before extraordinary credits. The \$80.7 million income before extraordinary credits represented a 49% increase over the previous high of \$54.3 million set in 1985. Income from the Chemicals business and GAF Broadcasting reached record levels, while the Building Materials business recorded its best year since 1978.

Net income for 1986 of \$293.2 million included \$201.4 million (\$5.55 per share) in extraordinary credits, after taxes and expenses, resulting from Union Carbide's January 1986 exchange offer, from Carbide's special third quarter dividend, and from the sale of Carbide shares in November (see Note 2 to Consolidated Financial Statements). In addition, there were \$11.1 million in extraordinary tax credits from the utilization of domestic and foreign operating loss carryforwards compared with the previous year's \$23.3 million.

Consolidated sales in 1986 of \$753.8 million were 3% higher than 1985 sales of \$732 million, reflecting increased unit sales for most of the Company's product lines, which more than offset the negative effects of lower domestic selling prices, primarily in residential roofing. For the three-year period ending in 1986, sales increased 7.8%. However, after adjusting consolidated sales for the sale or discontinuance of certain product lines, sales growth was 23.4%.

Consolidated operating income for 1986 of \$113.6 million increased 29% from last year's \$87.9 million. Gross profit margin, which was 29.8% in 1985, improved to 34.2% in 1986.

Chemicals reported record profits of \$107.8 million in 1986, a 16% increase over the previous high of \$92.6 million for the year 1985. Chemicals sales grew to \$377.5 million from \$364.4 million. This record-breaking performance resulted from several factors: a marked improvement in unit sales in most product lines resulting from strong domestic and international demand; a favorable product mix; lower raw material prices; continued cost improvements primarily due to manufacturing efficiencies; and the improved profitability from international operations reflecting increased market penetration and the continued decline of the U.S. dollar. These factors more than offset the effect of lower selling prices in a year when pricing in some product lines was softer than the corresponding decreases in raw material prices.

The Chemicals business continued to show returns on sales and identifiable assets that are among the highest in the specialty chemicals industry. The return on sales, which was 25.4% in 1985, jumped to 28.6% in 1986. The operating return on assets increased slightly in 1986 to 42.8% from last year's 42.6%, while total Chemicals identifiable assets increased by 16% to \$251.8 million.

The Company's Building Materials business posted a 49% improvement in profits in 1986 to \$30 million from last year's \$20.1 million, its third consecutive year of substantial earnings growth. Sales in 1986 were \$372.1 million, up from \$363.9 million in 1985, as an increase in residential and commercial roofing unit sales was partially offset by the continued erosion of selling prices. The improved profit performance resulted from continued cost control programs, manufacturing efficiencies, lower raw material prices, and a higher unit sales volume, which combined to more than offset the adverse effect of lower selling prices. Building Materials also benefited from a more favorable product mix as a result of new product introductions and increased sales emphasis on Timberline®, the Company's premium roofing product, and Royal Sovereign®, a residential shingle introduced in 1985.

In the last three years, Building Materials has recorded a \$64.5 million turnaround in operating results, from a loss

of \$34.5 million in 1983 to this year's income of \$30 million. This has enabled this business to show increasingly high operating margins and operating returns on assets. The return on sales improved in 1986 to 8.1% from last year's 5.5%, while the return on identifiable assets increased from 10.4% in 1985 to 15.5% in 1986.

Inflation has had a minimal direct impact on the Company's income from operations.

Interest expense increased in 1986 to \$35.4 million from last year's \$19.8 million, reflecting debt service on the Company's senior subordinated notes and debentures which were issued in June 1985 and November 1986. The higher interest expense was more than offset by substantially higher income from the Company's investment programs. Such income increased in 1986 to \$77.9 million from \$22.4 million in 1985, as detailed in Note 2 to Consolidated Financial Statements.

Other Expense-net in 1986 consists primarily of expenses and reserves in connection with products no longer manufactured or sold by the Company, offset by \$8.4 million of equity income from the Company's unconsolidated captive insurance company and the 50% ownership of GAF/Huls Chemie GmbH.

1985 Versus 1984

The Company's 1985 income before extraordinary credits of \$54.3 million was 32% higher than the prior year's \$41 million. Net income increased 37% to \$77.6 million from the previous year's \$56.7 million. Both figures at the time represented record highs in the Company's history.

Income from the Company's operations improved more than 25% in 1985 to \$113.8 million, reflecting a 17% increase in Chemicals profits from \$79 million to \$92.6 million, an 85% increase in Building Materials profits from \$10.9 million to \$20.1 million, and a 58% increase in GAF Broadcasting profits from \$0.7 million to \$1.1 million. Income from operations in 1984 had nearly tripled over 1983 levels to \$90.6 million as a result of 22% higher Chemicals profits and a \$45.4 million turnaround in Building Materials to a profit of \$10.9 million.

Consolidated sales increased slightly in 1985 to \$732 million after an increase of \$31.9 million (4.6%) in 1984. Chemicals sales were up \$7.2 million (2%) in 1985, while Building Materials sales of \$363.9 million were lower by \$6.9 million (2%).

Consolidated operating income for 1985 of \$87.9 million represented an increase of 41% from the prior year's \$62.2 million. Gross profit margin, which was 24.9% in 1984, increased to 29.8% in 1985.

The Chemicals business reported profits in 1985 of \$92.6 million, a 17% increase over the previous year's \$79 million. Operating margins in 1985 and 1984 were 25.4% and 22.1%, respectively. Chemicals continued to show an increasingly high operating return on assets, with a return of 42.6% and 38.8%, respectively, for the years 1985 and 1984.

In two years, Building Materials recorded a \$54.6 million swing in operating results to a profit of \$20.1 million in 1985, up 85% from \$10.9 million in 1984, and from a loss of \$34.5 million in 1983. This performance was achieved through major cost cutting and production efficiency programs. After three consecutive years of losses in 1981-1983, this turnaround enabled Building Materials to show operating returns on assets of 10.4% and 6.9% in 1985 and 1984, respectively.

Corporate operating expenses were reduced by \$3.1 million (16.8%) in 1985, after a decrease of \$4.2 million (18.5%) in 1984 as compared with 1983. These reductions were attributable to programs implemented in 1984 to decentralize operations, reduce corporate staffs, and relocate the Company's corporate headquarters. Interest expense was \$19.8 million in 1985 as compared with \$9.1 million in 1984. The increase in 1985 primarily reflects the debt service on the Company's senior subordinated notes which were issued in 1985, as well as borrowings in connection with the Company's investment programs. The added interest expense was more than offset by \$22.4 million in income on investments, as detailed in Note 2 to Consolidated Financial Statements.

Review of Consolidated Financial Information

GAF CORPORATION

Summary of Selected Financial Data

(Millions of Dollars, Except Per Share Amounts)
Year Ended December 31

	1986	1985	1984	1983	1982
Sales					
Chemicals	\$377.5	\$364.4	\$357.2	\$323.2	\$294.4
Building Materials	372.1	363.9	370.8	373.2	328.8
Broadcasting	4.2	3.7	3.3	3.0	—
Net Sales	753.8	732.0	731.3	699.4	623.2
Income (Loss) From Operations					
Chemicals	107.8	92.6	79.0	64.6	55.4
Building Materials	30.0	20.1	10.9	(34.5)	(26.3)
Broadcasting	1.3	1.1	0.7	0.5	—
Total	139.1	113.8	90.6	30.6	29.1
Income (Loss) From Continuing Operations	80.7	54.3	41.0	(29.2)	12.2
Per Common Share—					
Primary	2.22	1.57	1.31	(1.11)	.32
Fully Diluted	2.22	1.50	1.15	(1.11)	.35
Dividends Per Common Share	.10	.10	.05	.025	.25
As of December 31					
Current Assets	\$659.1	\$428.7	\$254.9	\$220.9	\$212.4
Current Liabilities	166.9	251.6	114.2	127.7	123.4
Working Capital	492.2	177.1	140.7	93.2	89.0
Marketable Securities	412.4	202.2	—	—	—
Property, Plant and Equipment—net	208.4	194.1	159.1	164.5	192.4
Total Assets	1,347.1	879.2	452.3	414.3	468.3
Short-term Debt	2.8	115.4	6.5	30.7	7.8
Total Long-term Debt	480.4	259.0	82.8	88.8	157.1
Shareholders' Equity	601.5	298.2	214.0	169.8	181.9
Percent of Debt to Debt Plus Equity	44.5%	55.7%	29.4%	41.3%	47.5%

Market for Common Stock

As of February 27, 1987, the common stock price was \$45.875, and there were 21,166 holders of record of the Company's outstanding common stock. The following information pertains to the Company's common stock, which is traded on the New York Stock Exchange.

Cash Dividends Per Common Share*

1986 1985

Price Range of Common Stock*

1986 1985

			High	Low	High	Low
First Quarter	\$0.025	\$0.025	\$37.125	\$23.875	\$15.6875	\$12.125
Second Quarter	.025	.025	37.25	32.00	17.9375	14.75
Third Quarter	.025	.025	36.875	28.375	18.9375	14.8125
Fourth Quarter	.025	.025	44.00	32.75	35.00	18.00

*Reflects a two-for-one stock split in 1986. See Note 6 to Consolidated Financial Statements.

Consolidated Statements of Income

GAF CORPORATION

(Thousands of Dollars, Except Per Share Amounts)
Year Ended December 31

	1986	1985	1984
Net Sales	\$753,774	\$731,962	\$731,314
Costs and Expenses:			
Cost of Products Sold	496,184	513,813	548,967
Selling, General and Administrative	143,943	130,206	120,139
Total Costs and Expenses	640,127	644,019	669,106
Operating Income	113,647	87,943	62,208
Income on Investments (Note 2)	77,930	22,438	4,151
Interest Expense	(35,437)	(19,799)	(9,143)
Other Expense—net	(30,664)	(3,108)	(2,598)
Income Before Income Taxes and Extraordinary Credits	125,476	87,474	54,618
Income Taxes (Note 3)	44,790	33,178	13,572
Income Before Extraordinary Credits	80,686	54,296	41,046
Extraordinary Credits (Notes 2 & 3)	212,475	23,285	15,656
Net Income	\$293,161	\$ 77,581	\$ 56,702
Earnings Per Common Share (Notes 1 and 6):			
Primary:			
Before Extraordinary Credits	\$ 2.22	\$ 1.57	\$ 1.31
Extraordinary Credits	5.86	.68	.54
Net Income	\$ 8.08	\$ 2.25	\$ 1.85
Fully Diluted:			
Before Extraordinary Credits	\$ 2.22	\$ 1.50	\$ 1.15
Extraordinary Credits	5.85	.65	.44
Net Income	\$ 8.07	\$ 2.15	\$ 1.59

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

GAF CORPORATION

Thousands of Dollars			1986	1985
December 31				
Assets				
Current Assets				
Cash			\$ 44,623	\$ 7,862
Short-term investments (Note 2)			407,840	209,298
Accounts receivable, less reserve	1986 \$4,382; 1985 \$5,142		112,681	109,580
Inventories (Note 1)			86,190	94,007
Other current assets			7,787	7,966
Total Current Assets			659,121	428,713
Marketable Securities (Note 2)			412,365	202,729
Property, Plant and Equipment—net (Note 1)			208,396	194,086
Other Assets			67,187	54,146
Total Assets			\$1,347,069	\$879,174
Liabilities and Shareholders' Equity				
Current Liabilities				
Short-term debt (Note 5)			\$ 2,757	\$115,380
Current maturities of long-term debt (Note 5)			335	10,132
Accounts payable			78,764	57,411
Accrued liabilities			79,289	58,924
Income taxes payable			5,805	9,785
Total Current Liabilities			166,950	251,632
Long-term Debt Less Current Maturities (Note 5)			480,114	248,853
Other Liabilities			98,507	80,536
Shareholders' Equity (Notes 6 & 7)				
Preferred stock, \$1 par value per share:				
authorized 6,000,000 shares			—	—
Common stock, \$1 par value per share: authorized 100,000,000 shares;				
issued shares: 1986—36,008,177; 1985—35,755,178			36,008	35,756
Additional paid-in capital			44,736	42,958
Retained earnings			519,207	229,586
Accumulated translation adjustment			3,928	(6,135)
Treasury stock, at cost			(2,381)	(4,012)
Shareholders' Equity			601,498	298,153
Total Liabilities and Shareholders' Equity			\$ 1,347,069	\$879,174

See Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Financial Position

GAF CORPORATION

(Thousands of Dollars)
Year Ended December 31

	1986	1985	1984
Cash and Short-term Investments, January 1	\$217,160	\$ 69,553	\$23,468
Source (Use) of Funds			
Income Before Extraordinary Credits	80,686	54,296	41,046
Charges not affecting funds:			
Depreciation	17,982	17,366	19,397
Other — net	1,814	5,308	4,209
Total funds from operations before extraordinary credits	100,482	76,970	64,652
Extraordinary Credits	212,475	23,285	15,656
Total funds from operations	312,957	100,255	80,308
Additions to property, plant and equipment	(33,914)	(47,161)	(17,900)
Acquisition of glass fiber facilities	—	(9,250)	—
Other working capital items*	42,633	2,492	24,024
Other	14,813	16,149	(1,824)
Total source before financing and investment activity	336,489	62,485	84,608
Financing and investment activity:			
Increase (decrease) in short-term debt	(112,623)	108,919	(24,285)
Increases in long-term debt	292,569	195,800	6,325
Decreases in long-term debt	(71,105)	(19,571)	(12,407)
Investment in marketable securities, net	(210,136)	(202,229)	—
Cash dividends	(3,540)	(4,118)	(4,393)
Other	3,649	6,321	(3,763)
Total source (use) from financing and investment activity	(101,186)	85,122	(38,523)
Increase in cash and short-term investments	235,303	147,607	46,085
Cash and Short-term Investments, December 31	\$452,463	\$217,160	\$69,553

*Other working capital items:	1985	1985	1984
Accounts receivable	\$ (3,101)	\$(14,441)	\$ 3,027
Inventories	7,817	(10,555)	7,299
Other current assets	179	(1,208)	1,759
Accounts payable	21,353	(457)	11,859
Accrued liabilities	20,365	22,362	(630)
Income taxes payable	(3,980)	6,791	710
Net source of funds	\$42,633	\$ 2,492	\$24,024

See Notes to Consolidated Financial Statements.

Consolidated Statements of Shareholders' Equity

GAF CORPORATION

(Thousands of Dollars)
Year Ended December 31

	1986	1985	1984
\$1.20 Convertible Preferred Stock:			
Balance, January 1	\$ —	\$ 3,175	\$ 3,187
Converted into common stock: 1985—2,428,625 shares; 1984—9,740 shares	—	(3,036)	(12)
Redemption of preferred stock—111,033 shares	—	(139)	—
Balance, December 31	—	—	3,175
Common Stock, \$1 Par Value Per Share:			
Balance, January 1	17,878	14,509	14,466
Effect of 2 for 1 stock split	17,878	—	—
Other activity	252	3,369	43
Balance, December 31	36,008	17,878	14,509
Additional Paid-in Capital:			
Balance, January 1	60,836	56,420	55,548
Effect of 2 for 1 stock split	(17,878)	—	—
Conversion of 5% convertible subordinated notes	—	7,167	669
Redemption of preferred stock	—	(2,888)	—
Excess of proceeds over cost of treasury common stock sold	1,137	13	128
Other activity	641	124	75
Balance, December 31	44,736	60,836	56,420
Retained Earnings:			
Balance, January 1	229,586	156,123	103,814
Net Income	293,161	77,581	56,702
Cash dividends:			
Preferred stock (per share: 1985—\$.30; 1984—\$.120)	—	(748)	(2,958)
Common stock (per share: 1986—\$.10; 1985—\$.10; 1984—\$.05)	(3,740)	(3,370)	(1,435)
Balance, December 31	518,207	229,586	156,123
Accumulated Translation Adjustment:			
Balance, January 1	(6,135)	(10,451)	(6,030)
Translation adjustment for the year	10,083	4,318	(4,371)
Balance, December 31	\$,928	(6,135)	(10,451)
Treasury Stock, at cost:			
\$1.20 Convertible preferred stock:			
Balance, January 1	—	(1,657)	(932)
Repurchase of odd-lot holdings—27,272 shares	—	—	(725)
Converted into common treasury shares—103,672 shares	—	1,657	—
Balance, December 31: 1984—103,672 shares	—	—	(1,657)
Common stock:			
Balance, January 1	(4,012)	(4,113)	(199)
Issued under various stock option and stock purchase plans: 1986—219,362 shares; 1985—198,424 shares; 1984—163,138 shares	1,890	1,758	1,062
Other activity	(259)	(1,657)	(4,976)
Balance, December 31: 1986—500,145 shares; 1985—453,640 shares; 1984—392,884 shares	(2,381)	(4,012)	(4,113)
Shareholders' Equity:	\$601,498	\$298,133	\$214,006

See Notes to Consolidated Financial Statements.

1. Summary of Significant Accounting Policies Principles of Consolidation

The accounts of all significant subsidiaries of the Company are included in the consolidated financial statements. All significant intercompany transactions and balances have been eliminated. A wholly owned captive insurance subsidiary and the 50% ownership of a foreign chemical manufacturing company are accounted for by the equity method.

Short-term Investments and Marketable Securities

Short-term investments and marketable securities are stated at the lower of cost or market. The determination of cost in computing realized gains and losses on investments is based on the specific identification method (see Note 2).

Inventories

Inventories are stated at the lower of cost (principally average) or market. Inventories at December 31 consist of the following:

Thousands of Dollars	1986	1985
Finished goods	\$47,315	\$49,748
Work in process	15,640	16,440
Raw materials and supplies	23,235	27,819
Total Inventories	\$86,190	\$94,007

Property, Plant and Equipment and Related Depreciation

Depreciation is computed principally on the straight-line method based on the estimated economic lives of the assets. Certain interest charges are capitalized as part of the cost of property, plant and equipment additions.

Property, Plant and Equipment at December 31 consist of the following:

Thousands of Dollars	1986	1985
Land and land improvements	\$ 16,403	\$ 16,760
Buildings and building equipment	56,814	53,631
Machinery and equipment	240,174	226,387
Construction in progress	16,197	11,362
Total	329,588	308,140
Less Accumulated Depreciation	(121,192)	(114,054)
Property, Plant and Equipment - net	\$208,396	\$194,086

Deferred Income Taxes

Deferred income taxes arise from reporting certain income and expense items in the financial statements in periods different from those in which such amounts are reported for income tax purposes.

Investment Tax Credits

The Company accounts for investment tax credits as a reduction of the provision for United States income tax (the flow-through method).

Research and Development

Research and development expenses are charged to operations as incurred and amounted to \$11.4 million in 1986, \$10.4 million in 1985 and \$8.7 million in 1984.

Earnings Per Common Share

Primary earnings per common share are based on the weighted average number of common and common equivalent shares outstanding during each year after giving appropriate effect for preferred stock dividends. Weighted average shares for computing primary earnings per share were (in thousands) 36,283 for 1986, 34,342 for 1985 and 29,020 for 1984.

Fully diluted earnings per share are based on the weighted average number of common and common equivalent shares outstanding and the assumed conversion of convertible securities outstanding after appropriate adjustment for interest on convertible notes. Weighted average shares for computing fully diluted earnings per share were (in thousands) 36,318 for 1986, 36,094 for 1985 and 35,986 for 1984.

2. Short-term Investments and Marketable Securities

At December 31, 1985, the Company held approximately a 10% interest in Union Carbide Corporation at a total cost of \$405.4 million, including \$60 million in costs relating to the Company's withdrawn tender offer. In January 1986, pursuant to Carbide's exchange offer, the Company received \$70 million in cash and \$227.5 million in Carbide bonds in exchange for 3.5 million of the Carbide shares it owned. After the exchange, the Company's ownership percentage of Carbide remained nearly the same. In November 1986, approximately one half of the remaining Carbide shares held by the Company were sold with the Company retaining a 4.8% interest in Carbide as of December 31, 1986.

Extraordinary credits for the year 1986 include a net gain of \$201.4 million, after taxes and expenses, resulting from the Carbide exchange offer in January 1986, from Carbide's special third quarter dividend, and from the sale of Carbide shares in November.

As of December 31, 1986, the Company held investments in Borg-Warner Corporation, CBI Industries Inc. and Union Carbide with a total cost basis of \$412.4 million. These investments are included in Marketable Securities and have an aggregate market value of \$455.9 million as of December 31, 1986.

Notes to Consolidated Financial Statements

Income on Investments consists of the following:

Millions of Dollars Year ended December 31	1986	1985	1984
Net realized gains, net of unrealized losses	\$42.4	\$ 8.9	\$ —
Dividends, interest income and other	35.5	13.5	4.2
Income on Investments	\$77.9	\$22.4	\$4.2

The Company received net proceeds from the sale of Carbide bonds in 1986 of approximately \$245 million, resulting in a net realized gain of \$17.5 million.

At December 31, 1986, the aggregate cost of the Company's short-term investments was \$411.9 million, while the aggregate market value was \$407.8 million.

3. Income Taxes

Income Taxes consist of the following:

Thousands of Dollars Year ended December 31	1986	1985	1984
Federal	\$28,321	\$19,684	\$ 4,932
Foreign	12,521	7,882	5,835
State	3,948	5,612	2,805
Income Taxes	\$44,790	\$33,178	\$13,572

The differences between the income tax provisions computed by applying the statutory federal income tax rate to pre-tax income and the actual tax provisions are as follows:

Thousands of Dollars Year ended December 31	1986	1985	1984
Statutory Provisions	\$57,719	\$40,238	\$25,125
Adjustments			
Dividend received deductions	(7,267)	(1,650)	—
Capital gains differential	(8,926)	(1,987)	—
Investment tax credits	(2,625)	(3,217)	(10,700)
Impact of foreign operations	2,042	(1,581)	(1,572)
State and local taxes	2,132	3,031	1,515
Other	1,715	(1,656)	(796)
Income Taxes	\$44,790	\$33,178	\$13,572

As of December 31, 1986, provision had not been made for United States income taxes on approximately \$29 million of unremitted earnings of consolidated foreign subsidiaries and the Company's 50% owned joint venture, because any United States taxes payable on foreign earnings which may be remitted in the future are expected to be substantially reduced by foreign tax credits.

Extraordinary credits for 1986, 1985 and 1984 include \$1,333,000, \$1,576,000 and \$1,830,000, respectively, representing the income tax benefit from the utilization of foreign operating loss carryforwards. The 1986, 1985 and 1984 extraordinary credits also include income tax benefits of \$9,764,000, \$21,709,000 and \$5,479,000 from the utilization of federal and state operating loss carryforwards. The 1986 extraordinary credits also include income tax benefits of \$19,462,000 related to the Company's partial disposition of its investment in Union Carbide Corporation (see Note 2).

4. Benefit Plans

The GAF Capital Accumulation Plan is a defined contribution plan for eligible salaried employees. Company contributions consist of a basic contribution of three percent of the compensation of participants for the plan year together with matching contributions, up to an additional four percent as specified in the plan, for those participants who have elected to make voluntary contributions to the plan. Each participant is fully vested at all times in the balance in each of his or her accounts in the plan. The aggregate contributions made by the Company to the plan and charged to operations in 1986, 1985 and 1984 were \$3,385,000, \$3,126,000 and \$2,896,000, respectively.

The Company has a deferred compensation plan for the benefit of key employees. The benefit payable under the plan, which accrues in accordance with a ten-year schedule, consists of an annual payment commencing at age 65 equal to 25% of a covered employee's last full year's salary. If a covered employee dies while employed by the Company, a death benefit of 36% of the employee's annual income at the date of death is payable to the employee's beneficiary for a term of 15 years. Employees who participate in this plan are not entitled to have employer contributions made to their accounts under the GAF Capital Accumulation Plan. The expense charged to operations in 1986 for such future obligations amounted to \$995,000.

The retirement plans for hourly employees and Texas City facility employees are noncontributory defined benefit plans. Company policy is to fund accrued pension expense. Pension expense charged to operations was \$870,000 in 1986, \$559,000 in 1985 and \$289,000 in 1984. A comparison of the accumulated plan benefits and plan net assets for these plans, after giving effect to the spin-off/termination as discussed in the following paragraph, is presented below:

Thousands of Dollars	1986	1985
Actuarial present value of accumulated plan benefits:		
Vested	\$2,884	\$1,877
Nonvested	926	502
Total	\$3,810	\$2,379
Plan assets available for benefits	\$1,532	\$1,216
Assumed rate of return	8%	8%
Plan valuation date	1/1/86	1/1/85

In 1984, the Company announced a proposed spin-off/termination involving its Retirement Plan for Hourly Employees, pursuant to which the Company purchased an annuity contract approximating \$69.6 million covering the benefits accrued to September 1, 1984 for participants of the plan. Assets were sufficient to provide for the accrued benefits of all hourly participants. Pursuant to government-

tal regulations, excess assets were then "spun-off" to a new plan for inactive members. The inactive plan was then terminated. Following government approvals of the spin-off/termination, excess assets of \$16.1 million reverted to the Company in November 1985. An additional \$3.8 million was received and established as a reserve pending final resolution of any plan liabilities. The Company will contribute to the plan in future years for active employees to meet liabilities as they accrue.

In addition to providing pension benefits, the Company and its subsidiaries provide certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees, including employees in foreign countries, may become eligible for those benefits if they reach normal retirement age while working for the Company. The cost of retiree health care and life insurance benefits (\$3.0 million, \$3.2 million and \$3.7 million in 1986, 1985 and 1984, respectively) is recognized as expense as claims are incurred.

As part of the 1977 and 1980 discontinuance programs, the Company provided health and life insurance coverage for certain retired employees of discontinued businesses. The balance of the liability for such future obligations at December 31, 1986 was \$14.7 million.

5. Debt and Dividend Restrictions

Information regarding short-term debt is as follows:

Thousands of Dollars	1986	1985	1984
As of December 31:			
Balance outstanding	\$ 2,757	\$115,380	\$ 6,461
Weighted average interest rate	6.2%	8.7%	8%
For the Year:			
Average month-end short-term debt outstanding	\$ 95,828	\$ 51,757	\$17,915
Maximum month-end short-term debt outstanding	\$185,559	\$118,315	\$45,789
Weighted average month-end interest rate	7%	8.6%	11.4%

Of the total short-term debt outstanding at December 31, 1985, \$99.4 million represented margin loans.

At December 31, 1986, the Company had unused short-term lines of credit aggregating approximately \$87.7 million (in addition to the revolving credit facility discussed below). The short-term lines of credit are maintained with banks on terms which expire on various dates, but are generally renewable. Borrowings generally bear interest at or near the prime commercial lending rate.

Long-term debt at December 31, 1986 and 1985 was as follows:

Thousands of Dollars	1986	1985
9½% senior notes due March 31, 1987	\$ —	\$ 10,600
8½% senior notes due January 15, 1992	—	16,700
Revolving credit agreement	—	27,000
Industrial revenue bonds with various interest rates and maturity dates to 2012. Certain assets are pledged as collateral thereto.	37,426	39,926
Obligation on mortgaged property	38,125	—
Obligation under capital lease	—	9,525
11¾% senior subordinated notes due June 15, 1995	150,000	150,000
10¾% senior subordinated notes due November 1, 1994	155,000	—
10¾% senior subordinated debentures due November 1, 2001	105,000	—
Other	454	5,234
Less unamortized discount	(5,556)	—
Total	480,449	258,985
Less current maturities	(335)	(10,132)
Long-term Debt Less Current Maturities	\$480,114	\$248,853

On June 30, 1986, the Company entered into a \$100 million three-year revolving credit facility with a consortium of ten banks, replacing the Company's previous \$75 million revolving credit agreement, which had been increased from \$50 million in May 1986. Interest on borrowings is, at the option of the Company, at the prime rate, a rate based on the London Interbank Offer Rate, or a rate based on the Certificate of Deposit Rate. Under the agreement, a commitment fee of ¾% per annum is charged on the daily average unused portion of the commitments. The agreement includes certain restrictions on dividends and provisions for the maintenance of minimum working capital, net worth and limitations on debt. As of December 31, 1986, \$138.4 million of retained earnings were available under this agreement for cash dividends and certain other special payments.

The Company in June 1985 issued \$150 million of 11¾% senior subordinated notes due June 15, 1995. The notes will be redeemable at the option of the Company on and after June 15, 1992.

In October 1986, the Company placed a \$38.1 million mortgage on the Company's headquarters property. The mortgage is due on October 8, 1996, and interest on the funds is at a rate based on the London Interbank Offer Rate.

In November 1986, the Company issued \$155 million of 10¾% senior subordinated notes due 1994 and \$105 million of 10¾% senior subordinated debentures due 2001. The notes will be redeemable at any time, at the option of the Company, after October 31, 1991, while the debentures will be redeemable at any time, at the option of the Company, after October 31, 1995. Annual sinking fund pay-

Notes to Consolidated Financial Statements

ments of 18.75% of the principal amount of the debentures originally issued, commencing November 1, 1997, are calculated to retire 75% of the principal amount of the debentures prior to maturity. The securities will be subordinated to all existing and future senior indebtedness of the Company.

The aggregate maturities of long-term debt for the next five years are as follows:

Thousands of Dollars

1987	\$ 335
1988	347
1989	1,361
1990	41
1991	—

6. Capital Stock

The Company declared a two-for-one stock split effective May 8, 1986. All references in the Financial Statements to the number of common shares, earnings and dividend amounts per share, stock option data and other per share amounts have been restated to give effect to the stock split.

The Company in 1985 called for redemption all of its outstanding shares of \$1.20 convertible preferred stock. Shareholders converted 2,324,553 shares of preferred stock into 5,810,288 shares of common stock, and the Company redeemed 111,033 shares of preferred stock at a price of \$27.50 plus accrued dividends. In addition, the Company converted all 103,672 shares of its \$1.20 convertible preferred stock held in treasury into 259,180 shares of common stock to be held in treasury.

At December 31, 1986, there were 3,612,514 shares of common stock reserved for issuance under the Company's stock option and stock purchase plans.

7. Stock Option and Stock Purchase Plans

The Company's 1984 Stock Option Plan provides for the granting of incentive and nonqualified stock options to key employees of the Company and its subsidiaries to purchase common stock of the Company at not less than 100% of the fair market value at the date of grant. Under the terms of the plan, options for 1,600,000 shares of common stock may be granted from time to time until April 30, 1989. The term of each option is five years and sixty days. Options may not be exercised during the first year after the date of grant, but thereafter, options become exercisable as to 20% of the shares subject thereto on each of the first through the fifth anniversaries of the date of grant.

The Company's 1975 nonqualified stock option plan provided for the granting of 1,600,000 options to key employees to purchase common stock of the Company at not less than 100% of the fair market value at the date of grant. Options granted through April 30, 1984 were exer-

cisable one year after grant and expire after 10 years.

Options granted after April 30, 1984 are subject to the same terms and conditions as options issued under the 1984 Stock Option Plan. The 1975 plan terminated in 1985, and no additional options have been granted after that date.

The plans provide for limited stock appreciation rights permitting the option holder to surrender exercisable options in the event of a tender or exchange offer for the Company's common stock made by someone other than the Company.

The following is a summary of certain information pertaining to the 1975 and 1984 stock option plans:

Shares	1986	1985	1984
Outstanding January 1	1,344,200	1,351,600	508,800
Granted	277,600	184,010	960,800
Exercised	(109,068)	(116,370)	(104,000)
Terminated	(87,970)	(75,040)	(14,000)
Outstanding December 31	1,424,762	1,344,200	1,351,600
At December 31			
Exercisable	547,290	461,790	403,800
Available for grant	596,480	787,190	900,400
Option Price Range Per Share			
Outstanding	\$ 4.81- \$38.50	\$ 4.81- \$23.13	\$ 4.81- \$11.88
Exercised	\$ 4.81- \$23.13	\$ 4.81- \$11.88	\$ 4.81- \$ 7.44

The Company's 1984 Employee Stock Purchase Plan provides for grants of options to purchase 1,200,000 shares of common stock on a nondiscriminatory basis to all eligible employees of the Company and its subsidiaries. No options to purchase shares of common stock under the plan may be granted after April 30, 1989. The price at which shares may be purchased is the lesser of (i) 85% of the fair market value on the date of grant or (ii) 85% of the fair market value on the date of purchase. As of December 31, 1986, 178,508 shares of common stock had been issued under the plan.

Under the provisions of the Company's 1969 Restricted and Unrestricted Stock Purchase Plan, 1,300,000 shares of common stock were authorized for sale to key employees. The plan currently provides that restricted and unrestricted shares may be sold at prices which are not less than 50% and 80%, respectively, of the closing market price preceding the date of grant. To date, only restricted shares have been offered for sale. Under certain conditions, the Company has the right to repurchase restricted shares of common stock at the original selling price. At December 31, 1986, there were 569,780 shares available for sale under this stock purchase plan.

8. Business Segments Information

Millions of Dollars Year ended December 31	1986	1985	1984
Sales			
Chemicals*	\$ 377.5	\$364.4	\$357.2
Building Materials	372.1	363.9	370.8
Broadcasting	4.2	3.7	3.3
Consolidated Net Sales	\$ 753.8	\$732.0	\$731.3
Income From Operations			
Chemicals**	\$ 107.8	\$ 92.6	\$ 79.0
Building Materials	30.0	20.1	10.9
Broadcasting	1.3	1.1	0.7
Total	139.1	113.8	90.6
Corporate:			
Operating Expenses	(16.1)	(15.4)	(18.5)
Interest Expense	(35.4)	(19.8)	(9.1)
Other Income (Expense)—net	37.9	8.9	(8.4)
Net Corporate Expenses	(13.6)	(26.3)	(36.0)
Income Before Income Taxes and Extraordinary Credits	\$ 125.5	\$ 87.5	\$ 54.6
Identifiable Assets			
Chemicals**	\$ 251.8	\$217.3	\$203.8
Building Materials	194.0	194.2	158.6
Corporate and other	901.3	467.7	89.9
Total Assets	\$1,347.1	\$879.2	\$452.3
Additions to Property, Plant and Equipment			
Chemicals	\$ 13.4	\$ 21.5	\$ 9.6
Building Materials	20.3	24.4	8.0
Corporate and other	0.2	1.3	0.3
Total	\$ 33.9	\$ 47.2	\$ 17.9
Depreciation			
Chemicals	\$ 9.6	\$ 10.3	\$ 11.1
Building Materials	7.5	6.0	7.0
Corporate and other	0.9	1.1	1.3
Total	\$ 18.0	\$ 17.4	\$ 19.4

*Chemicals sales are net of intersegment sales of \$29.1 million, \$27.4 million and \$23.2 million for 1986, 1985 and 1984, respectively. Intersegment sales are recorded at the same prices charged to unaffiliated customers.

**Chemicals income and identifiable assets include the Company's 50% equity in the income and assets of GAF/Hüls Chemie GmbH, a joint venture between GAF Corporation and Hüls A.G., which operates a chemical manufacturing plant in West Germany.

Notes to Consolidated Financial Statements

9. Geographic Information

Millions of Dollars Year ended December 31	1986	1985	1984
Domestic Operations:			
Net Sales*	\$ 638.8	\$642.9	\$649.9
Operating Income	\$ 90.5	\$ 73.3	\$ 49.2
Other Income (Expense)	8.8	(7.3)	(14.9)
Income Before Income Taxes and Extraordinary Credits	\$ 99.3	\$ 66.0	\$ 34.3
Identifiable Assets	\$1,255.1	\$826.6	\$404.8
Foreign Operations:			
Net Sales**	\$ 115.0	\$ 89.1	\$ 81.4
Operating Income	\$ 23.2	\$ 14.6	\$ 13.0
Other Income (Expense)***	3.0	6.9	7.3
Income Before Income Taxes and Extraordinary Credits	\$ 26.2	\$ 21.5	\$ 20.3
Identifiable Assets***	\$ 92.0	\$ 52.6	\$ 47.5

*Domestic sales are net of transfers between geographic areas of \$46.6 million, \$40.8 million and \$34.9 million, respectively.

**Foreign sales are net of transfers between geographic areas of \$7.7 million, \$10.4 million and \$7.3 million, respectively.

***Foreign Operations income and identifiable assets include the Company's 50% equity in the income and assets of CAF/Hüls Chemie GmbH.

10. Commitments and Contingencies

The Company has operating leases for transportation and data processing equipment and for various buildings. Future minimum lease payments for properties which are held under long-term noncancelable leases as of December 31, 1986 are as follows:

Thousands of Dollars Minimum Payments	
1987	\$ 5,368
1988	1,965
1989	1,364
1990	1,044
1991	544
Later Years	51
Total minimum payments	\$10,336

At December 31, 1986, there were various lawsuits pending against the Company relating to matters arising from its business, including approximately 27,000 involving bodily injury claims relating to the exposure to asbestos or asbestos-containing products no longer sold by the Company. The Company is also named as a defendant in approximately 70 asbestos-in-building lawsuits by school districts and other owners of buildings seeking to recover damages including the cost of removal of asbestos insulation and other asbestos products.

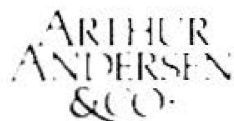
The Company, in January 1987, resolved a long-standing dispute with five insurance carriers over the nature and extent of insurance coverage for asbestos-related health claims filed against the Company. In connection with these settlements, the Company has joined the Wellington Asbestos Claims Facility (the "Facility"), an organization of insurance companies and asbestos producers formed in 1985 to coordinate the administration of asbestos claims.

The Facility will assume defense and settlements of all such pending, threatened and future claims against the Company. The Company's share of the cost of settlements, judgments and legal expenses with respect to such claims will be borne by the Facility, which will be reimbursed by the Company's insurers on the basis of the amounts provided by the Facility's agreement with the Company and to the extent of the coverage afforded the Company under its policies of insurance and settlement agreements. The Company also entered into a separate agreement with another of its insurers, with which it had previously settled its insurance coverage claim, so as to conform that arrangement with the aforesaid settlements and the Company's entry into the Facility.

In the opinion of management, the ultimate disposition of the lawsuits pending against the Company, including the asbestos related claims, will not have a material adverse effect on the Company's consolidated financial position.

11. Supplementary Financial Information

Thousands of Dollars Year ended December 31	1986	1985	1984
Maintenance and repairs	\$45,774	\$41,068	\$41,796
Rentals—operating leases	6,789	6,296	7,746



101 Eisenhower Parkway
Roseland, New Jersey 07068

To the Shareholders and Board of Directors of
GAF Corporation:

We have examined the consolidated balance sheets of GAF Corporation (a Delaware corporation) and subsidiaries as of December 31, 1986 and 1985, and the related consolidated statements of income, changes in financial position and shareholders' equity for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of GAF Corporation and subsidiaries as of December 31, 1986 and 1985, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.
Arthur Andersen & Co.

February 9, 1987

Supplementary Data (Unaudited)

Quarterly Financial Data (Unaudited)

Millions of Dollars Except Per Share Amounts	1986 by Quarter				1985 by Quarter			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Net Sales	\$176.0	\$198.3	\$197.2	\$182.3	\$175.9	\$188.1	\$193.8	\$174.2
Cost of Products Sold	122.1	130.6	127.1	116.4	127.1	130.2	135.1	121.4
Gross Profit	\$ 53.9	\$ 67.7	\$ 70.1	\$ 65.9	\$ 48.8	\$ 57.9	\$ 58.7	\$ 52.8
Income Before Income Taxes and Extraordinary Credits	\$ 23.3	\$ 35.5	\$ 37.5	\$ 29.2	\$ 19.5	\$ 25.2	\$ 24.9	\$ 17.9
Income Taxes	8.3	13.3	13.0	10.2	8.4	9.8	9.3	5.7
Income Before Extraordinary Credits	15.0	22.2	24.5	19.0	11.1	15.4	15.6	12.2
Extraordinary Credits	85.8	3.7	92.5	30.5	6.4	8.4	7.3	1.2
Net Income	\$100.8	\$ 25.9	\$117.0	\$ 49.5	\$ 17.5	\$ 23.8	\$ 22.9	\$ 13.4
Earnings Per Common Share*								
Primary								
Before Extraordinary Credits	\$.41	\$.61	\$.67	\$.52	\$.36	\$.44	\$.43	\$.34
Extraordinary Credits	2.37	.10	2.55	.84	.21	.24	.21	.03
Net Income	\$ 2.78	\$.71	\$ 3.22	\$ 1.36	\$.57	\$.68	\$.64	\$.37
Fully Diluted:								
Before Extraordinary Credits	\$.41	\$.61	\$.67	\$.52	\$.31	\$.44	\$.43	\$.34
Extraordinary Credits	2.37	.10	2.55	.84	.18	.24	.21	.03
Net Income	\$ 2.78	\$.71	\$ 3.22	\$ 1.36	\$.49	\$.68	\$.64	\$.37

*In accordance with the provisions of APB Opinion No. 15, earnings per share are calculated separately for each quarter and the full year. Accordingly, annual earnings per share will not necessarily equal the total of the interim periods.

Board of Directors and Officers

Board of Directors

Daniel T. Carroll
Chairman of the Board and
President,
The Carroll Group, Inc.
(management consulting)

Carl R. Eckardt
Executive Vice President
Corporate Development,
GAF Corporation

Dr. Jacob E. Goldman
Chairman of the Board,
Cauzin Systems Inc.
(manufacturer of personal
computer accessories)

Samuel J. Heyman
Chairman of the Board
and Chief Executive Officer,
GAF Corporation

Sanford Kaplan
Private investor and
consultant

William P. Lyons
President,
William P. Lyons & Co., Inc.
(investment banking
and financial consulting)

Scott A. Rogers, Jr.
Consultant

Edward E. Shea
Partner,
Windels, Marx,
Davies & Ives

James T. Sherwin
Vice Chairman and Chief
Administrative Officer,
GAF Corporation

William Spier
Private investor

Joseph D. Tydings
Partner,
Finley Kumble, Wagner,
Heine, Underberg,
Manley & Casey

Corporate Officers

Samuel J. Heyman
Chairman of the Board
and Chief Executive Officer

James T. Sherwin
Vice Chairman and Chief
Administrative Officer

Carl R. Eckardt
Executive Vice President,
Corporate Development

John A. Brennan
Executive Vice President
and President,
GAF Building Materials
Corporation

Heinn F. Tomfohrde, III
Executive Vice President
and President,
GAF Chemicals
Corporation

Joel A. Asen
Senior Vice President,
Treasury and Business
Development

Irving Kagan
Senior Vice President,
General Counsel, and
Secretary

Raymond J. Lacroix
Senior Vice President and
Chief Financial Officer

Matthew L. Gooby
Vice President,
Management Information
Systems

Bernard L. Kapell
Vice President,
Taxation

Frank E. Sheeder, Jr.
Vice President,
International

James J. Strupp
Vice President,
Human Resources

Chemicals Corporation

Heinn F. Tomfohrde, III
President

William J. Burlant
Vice President,
Research & Development

T.H. King
Vice President, Mineral
Products

Abraham Lindenauer
Vice President,
Materials Management &
Technical Services

Richard B. Olsen
Vice President, Finance

Frank E. Sheeder, Jr.
Vice President,
International

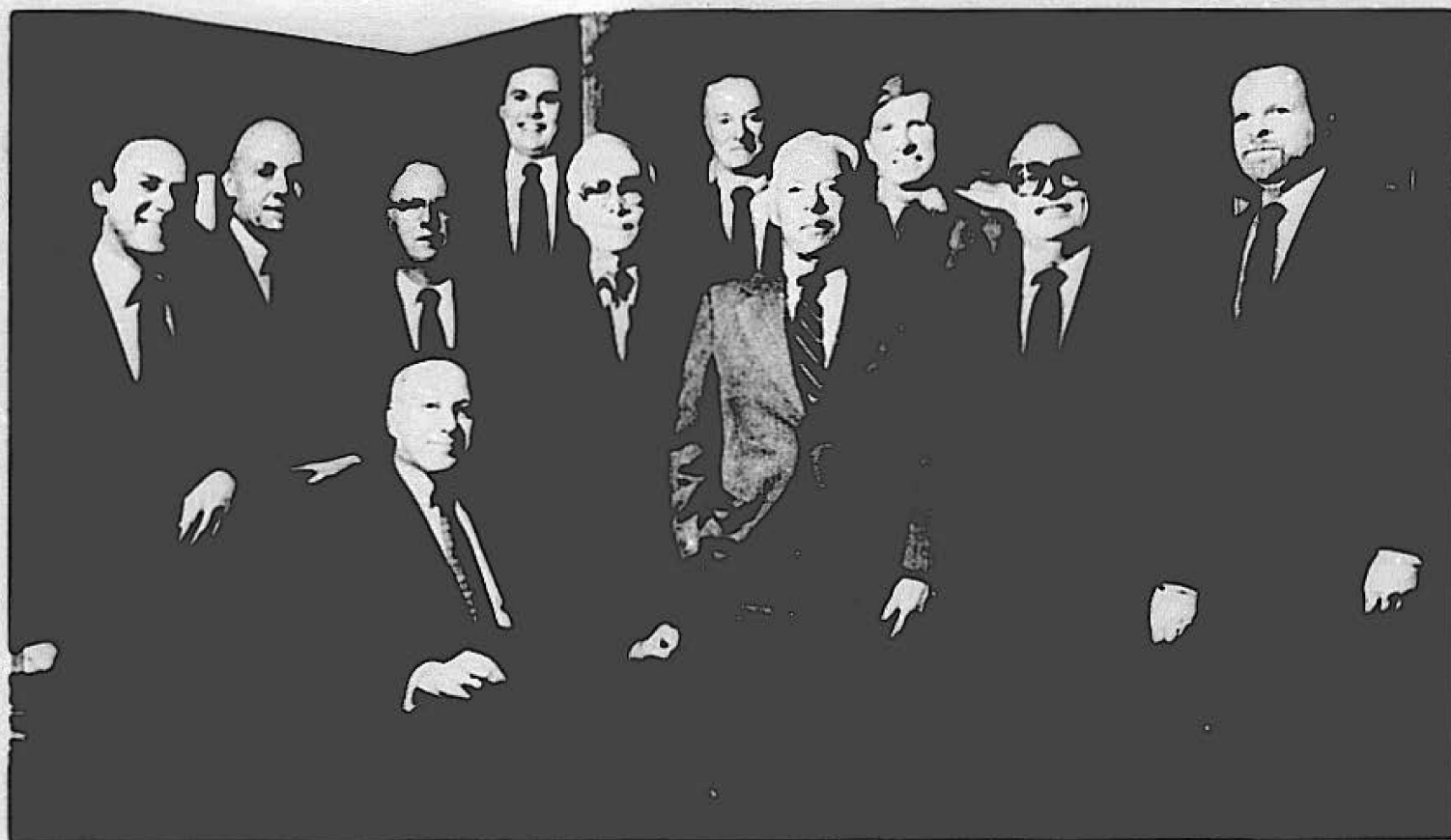
Raymond W. Smith
Vice President,
Acetylenic Derivatives

Richard L. Toma
Vice President,
Manufacturing

Gerald R. Whitmore
Vice President,
Human Resources



Heinn F. Tomfohrde, III



Samuel J. Heyman (seated), Chairman and Chief Executive Officer, and the GAF Board of Directors (left to right): James T. Sherwin, Edward E. Shea, Carl R. Eckardt, William P. Lyons, Sanford Kaplan, Daniel T. Carroll, Scott A. Rogers, Jr., Joseph D. Tydings, Dr. Jacob F. Goldman, and William Spier.

John A. Brennan
President

Salvatore C. Bellini
Vice President, Finance

Robert A. Goodman
Vice President, Human Resources

William C. Schwingen
Vice President, Commercial Development and Research & Development

Thomas J. Zickell
Vice President, Manufacturing



John A. Brennan

Matthew Field
Vice President and General Manager



Matthew Field



Corporate Offices
1361 Alps Road
Wayne, New Jersey 07470

Domestic:
GAF Corporation's plants, research laboratories, and sales offices are located throughout the United States.

Chemicals

Manufacturing
Alabama-Huntsville
Kentucky-Calvert City
Missouri-Annapolis
New Jersey-Bound Brook
New Jersey-Linden
Pennsylvania-Blue Ridge Summit
South Carolina-Spartanburg
Texas-Seadrift
Texas-Texas City
Wisconsin-Pembine

Sales

California-Irvine
Illinois-Lombard
New Jersey-Linden
North Carolina-Charlotte
Ohio-Cincinnati
Pennsylvania-King of Prussia
Texas-Arlington

Research & Development
Maryland-Hagerstown
New Jersey-Wayne

Building Materials

Manufacturing
Alabama-Mobile

California-Fontana
California-Irwindale
Florida-Tampa
Georgia-Savannah
Indiana-Mount Vernon
Maryland-Baltimore
Massachusetts-Millis
Minnesota-Minneapolis
Pennsylvania-Erie
South Carolina-Chester
Tennessee-Nashville
Texas-Dallas

Sales

Alabama-Mobile
California-Fontana
Florida-Tampa
Georgia-Savannah
Indiana-Mount Vernon
Massachusetts-Millis
Minnesota-Minneapolis
New Jersey-South Bound Brook
Pennsylvania-Erie
Texas-Dallas

Research & Development
New Jersey-Wayne
Tennessee-Nashville

International
GAF Corporation's major marketing and service facilities are located throughout the world.

European Region
Great Britain, Esher-Headquarters
Austria-Vienna
Belgium-Sint Niklaas
France-Paris

Great Britain-Manchester
Italy-Milan
Netherlands-Schiedam
Spain-Barcelona
Sweden-Johanneshov (headquarters for Norden countries)
Switzerland-Zug
West Germany-Frechen

Western Hemisphere Region
New Jersey, Wayne-Headquarters
Brazil-São Paulo
Canada-Mississauga, Ontario
Canada-Ville St. Laurent, Quebec
Mexico-Mexico City
Puerto Rico-Carolina

Asia-Pacific Region
Republic of Singapore, Singapore-Headquarters
Australia-Sydney
Australia-Melbourne
Japan-Tokyo
New Zealand-Auckland
Republic of Singapore-Singapore

GAF Broadcasting Company, Inc.
New York, New York

Subsidiary:
GAF Insurance, Ltd.
Hamilton, Bermuda

Affiliate:
GAF/Hüls Chemie GmbH
Marl, West Germany

Shareholder Information

Annual Meeting

The 1987 Annual Meeting of Shareholders will be held at 9 a.m., Monday April 27, at:
Century Plaza Hotel
Westside Room
2025 Avenue of the Stars
Century City, Los Angeles, California 90067

Form 10K

A copy of the Company's Annual Report on Form 10K, as filed with the Securities and Exchange Commission, may be obtained free of charge by writing to:
GAF Corporation
Corporate Affairs Department
1361 Alps Road
Wayne, New Jersey 07470
(201) 628-3000

Dividend Reinvestment Service

GAF offers holders of its common stock the opportunity to buy additional shares through an automatic dividend reinvestment service, administered by Morgan Shareholder Services Trust Company. For further details contact:
Morgan Shareholder Services Trust Company
30 West Broadway
New York, New York 10007

GAF Corporation's common stock is listed on the New York Stock Exchange (symbol: "GAF").

Stock Transfer Agent and Registrar

Morgan Shareholder Services Trust Company
30 West Broadway
New York, New York 10007
(212) 587-6515

